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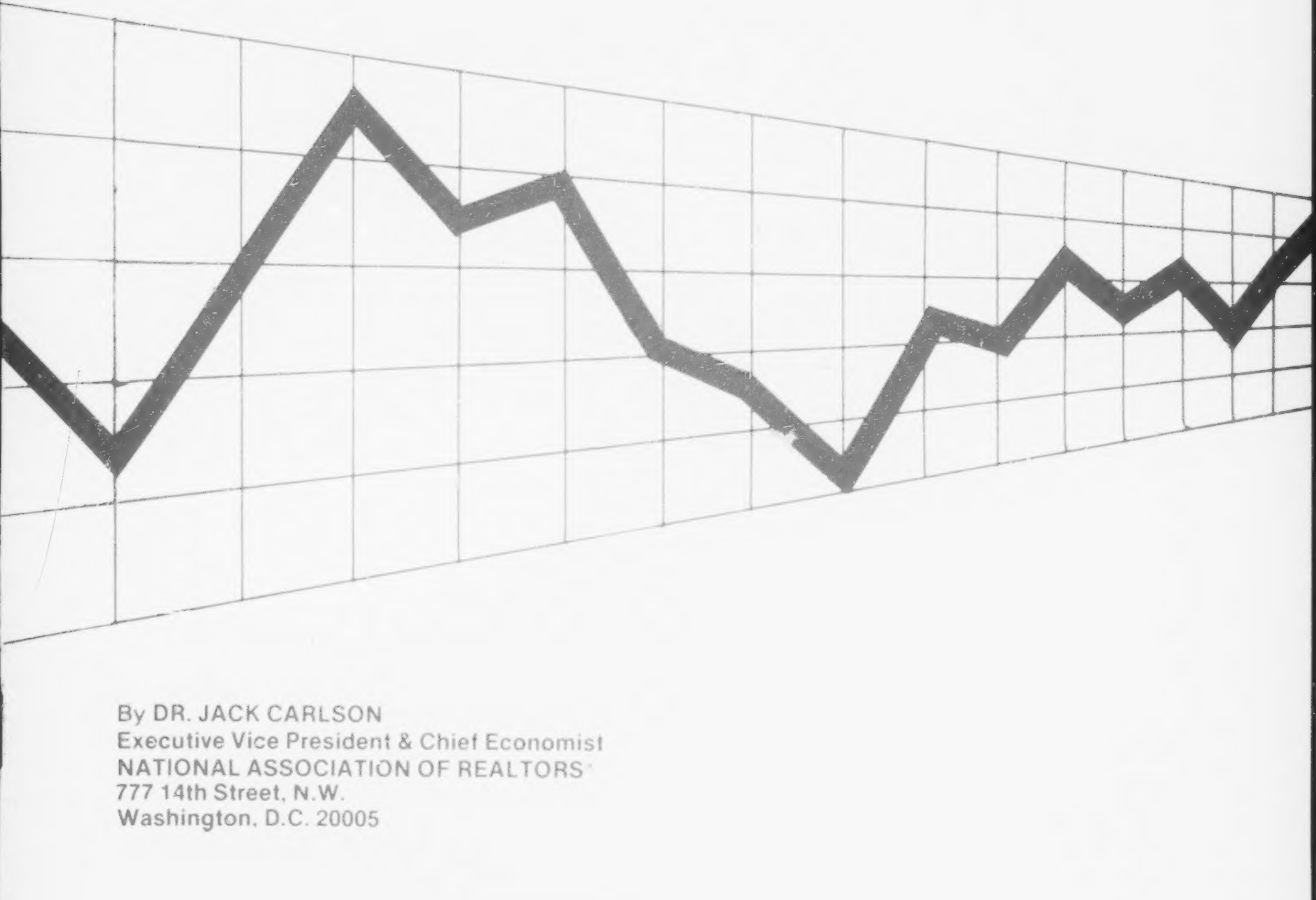
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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Outlook For the Economy and Real Estate

The 3.3 percent increase in real GNP during the third quarter represents a marked improvement over the 1 percent growth rate of the first half of the year. However, at present, there is no evidence that this trend will continue through 1986. Most of the improvement in the third quarter growth was due to a temporary surge in auto sales and government purchases of defense goods, while the underlying trends in production and investment remained weak. It is, therefore, unlikely that the strong pace of spending experienced during the third quarter will be sustained. Already, auto sales have weakened in October as many incentive programs have expired. Most importantly, the funds needed for a continuation of the spending spree are becoming scarce as the savings rate has plunged to below 2 percent and household debt burdens have reached historic highs. Subsequently, growth in economic activity is expected to dip below 3 percent by years' end before slowing to near 2 percent through 1986. Despite expectations of below average growth, a recession is not likely as renewed growth in exports, an accommodating monetary policy, and the continued stimulus from federal deficit spending will keep the economy afloat.

The stagnation of the civilian unemployment rate in September despite a substantial rise in employment underscores the slowing in economic activity. By 1986, the increase in new entrants to the labor force accompanied by weaker economic growth could push unemployment back up to 7.5 percent. By 1987, however, stronger job growth should resume allowing the unemployment rate to decline to 7.3 percent.

The one bright spot has been the outlook for inflation. While consumer prices have been rising only modestly, producer prices continue to decline. Consumer price inflation is expected to increase 3.4 percent in 1985 and only 3.1 percent in 1986 as declining energy prices and slow growth put downward pressure on prices.

As the demand for credit weakens and inflation remains near 3 percent, long term interest rates should continue to trend downward through 1987. Short term rates should experience a modest upturn during the fourth quarter due to an increase in the supply of new Treausury issues when the debt limit is raised. By 1986, however, short term rates should resume their downward trend before increasing modestly in 1987.

Real Estate Markets

Home resale markets remained robust in September as mortgage interest rates on loans closed fell to six-year lows and the demand for homeownership continued to be strong. The September pace of resales--at a seasonally adjusted annual rate of 3.44 million units--was 26 percent above the 2.73 million unit rate recorded in September 1984. Home prices have outpaced inflation increasing at a 4.7 percent rate since last September. The outlook for resales remains favorable. As mortgage rates fall through 1986 and 1987, 3.3 million homes could be sold in 1986, and 3.4 million in 1987. Housing starts, after declining modestly in September, are also expected to increase through 1986 as indicated by the recent surge in building permits. In 1986, 1.8 million units are expected to be started.

The outlook for nonresidential construction remains mixed. Within commercial investment, construction of retail space should remains strong as increased housing spurs demand for nearby stores. Office construction, on the other hand, will weaken in 1986 as higher vacancy rates and oversupply dampen investment in this area.

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:2	85:3	85:4	86:1	86:2	86:3	86:4	87:1	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,851	3,916	3,976	4,021	4,080	4,107	4,138	4,226	3,305	3,663	3,889	4,085	4,341
Percent Change	4.5	6.7	6.3	4.6	5.9	4.3	5.3	6.9	7.7	10.8	6.2	5.0	6.3
Percent Change (without inflation)	1.9	3.3	2.0	1.5	1.5	2.0	2.3	3.3	3.7	6.8	2.4	2.0	3.0
Consumption	4.8	4.8	-1.0	1.7	2.0	3.4	2.2	3.2	4.8	5.3	4.0	2.0	2.3
Durables	4.8	20.3	-17.8	0.7	0.4	0.8	2.8	4.5	12.1	13.1	7.7	0.4	2.9
Nondurables	4.7	0.6	2.0	1.8	1.5	1.8	1.3	2.3	3.7	4.6	2.4	1.8	1.6
Services	4.2	2.7	3.6	2.7	2.4	2.7	3.0	3.3	3.4	3.2	3.9	2.7	2.9
Residential Investment	6.1	10.9	4.5	2.2	3.5	5.9	8.5	7.3	41.7	12.2	3.9	3.3	4.4
Nonresidential Investment	14.4	-4.6	-4.8	-1.4	0.3	1.4	1.9	5.4	2.5	19.8	5.3	0.2	4.0
Structures	4.0	-2.0	0.5	-3.6	5.0	-4.7	-4.2	3.8	-7.8	15.6	7.6	-2.6	0.7
Equipment	16.6	-5.5	-6.8	-0.2	3.4	3.9	4.6	6.7	7.1	21.5	4.9	0.1	5.2
Exports	-15.2	0.6	4.5	7.0	8.1	8.1	4.8	9.3	5.0	4.7	-4.2	4.8	8.7
Imports	20.5	0.7	4.8	-2.5	3.8	2.9	3.3	3.2	7.8	25.0	7.1	1.0	2.6
Government Purchases	9.5	16.1	4.5	-2.2	-0.3	-0.1	0.7	0.9	-0.1	3.5	3.2	[illegible]	0.9
Consumption (% of GNP)	65.4	66.1	65.7	65.7	65.6	65.9	65.8	65.8	65.8	64.8	65.6	65.8	65.5
Residential Investment (% of GNP)	4.6	4.7	4.6	4.5	4.5	4.5	4.6	4.6	4.4	4.7	4.7	4.7	4.8
Nonresidential Investment (% of GNP)	12.9	12.5	12.5	12.4	12.4	12.5	12.5	12.4	11.1	12.0	12.9	12.6	12.7
Structures (% of GNP)	3.7	3.6	3.6	3.6	3.5	3.5	3.4	3.4	3.2	3.3	3.6	3.5	3.4
Equipment (% of GNP)	9.1	9.0	9.0	9.1	9.1	9.1	9.1	9.0	7.9	9.0	9.3	9.1	9.3
Inventory Change ($ billions)	17.4	4.1	41.5	47.0	42.4	39.5	35.9	31.4	-11.3	58.2	22.9	41.2	44.3
Mfg. Capacity Utilization Rate (%)	80	80	79	79	78	78	78	78	74	81	80	78	78
Auto Sales (millions of units)	10.9	12.5	10.6	10.5	10.6	10.8	10.7	10.8	9.2	10.4	11.2	10.6	10.8
Domestic (% of Total)	75.5	75.8	68.4	73.1	69.9	68.2	67.7	68.2	74.0	76.7	74.4	69.8	67.6
Imported (% of Total)	24.5	24.2	31.6	26.9	30.1	31.8	32.3	31.8	26.0	23.3	25.6	30.2	32.4
Manufacturing Industrial Production (% change)	2.0	3.3	5.1	3.6	4.0	3.9	3.8	3.4	7.8	11.3	2.4	3.7	4.7
Common Market	3.0	4.0	1.0	2.8	3.0	0.0	2.2	0.8	1.0	3.0	3.4	2.1	1.4
Japan	-1.1	3.1	1.7	4.3	4.0	3.4	3.3	-0.6	3.3	11.0	3.4	3.2	1.6
Trade Deficit	131	124	130	130	121	122	120	118	67	102	123	121	116
Value of the U.S. Dollar (Tradeweighted)	1.317	1.249	1.243	1.196	1.158	1.136	1.108	1.086	1.147	1.224	1.289	1.148	1.088
Percent Change - Year Ago	2.6	[illegible]	-1.1	-11.7	-11.9	-9.9	-10.9	-8.7	4.0	7.2	5.3	-10.9	-5.2
Employment (millions) (civilian household basis)	106.8	107.2	107.5	108.1	108.4	108.6	109.0	109.4	100.8	105.0	107.1	108.5	110.2
Percent Change	2.1	1.5	1.1	[illegible]	[illegible]	1.7	1.6	1.5	1.3	4.1	2.0	1.3	1.6
Unemployment Rate (%) (civilian)	7.3	7.1	7.1	7.3	7.3	7.4	7.5	7.6	9.6	7.5	7.2	7.4	7.5
Personal Income per Household (average)(1)	40,190	40,610	41,200	41,752	42,108	42,698	43,148	43,619	35,416	38,527	40,389	42,449	44,775
Percent Change -- Year Ago (w/o inflation)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.6	1.9	1.5	5.4	2.0	1.7	1.9
Personal Taxes per Household (average)	7,676	7,723	7,800	7,902	8,087	8,206	8,317	8,433	6,498	6,956	7,641	8,147	8,859
Percent Change -- Year Ago (w/o inflation)	7.4	8.2	[illegible]	[illegible]	8.0	[illegible]	7.4	5.0	-3.0	1.5	5.9	5.7	7.0
Percent of Personal Income	18.8	19.9	20.0	20.0	20.0	20.0	20.2	20.1	18.3	18.8	19.1	20.1	20.3
Disposable Income per Household (average)	33,714	33,909	33,798	33,875	34,022	34,449	34,831	35,406	28,918	31,571	32,929	34,303	36,116
Percent Change--Year Ago (w/o inflation)	2.7	0.4	[illegible]	1.0	0.8	1.0	1.6	1.7	2.0	5.5	1.5	1.1	1.7
Household Debt (% of total)	23.7	24.0	24.3	25.0	25.0	24.5	24.8	24.6	19.7	21.3	24.1	24.9	24.4
Household Interest Payments (% of total)	[illegible]	[illegible]	10.9	11.1	11.0	11.0	10.4	10.2	9.7	10.4	10.8	10.9	10.2
Consumer Price Inflation (CPI)	4.1	2.4	3.8	3.2	3.6	3.9	3.6	3.3	3.2	4.3	3.4	3.1	3.5
Gross National Product Inflation (GNP Deflator)	2.6	3.3	4.2	3.1	4.4	4.1	3.3	3.6	3.8	3.8	3.7	3.0	3.3
Personal Consumption Inflation	2.3	2.1	3.5	3.1	3.1	[illegible]	3.3	3.6	3.7	3.3	3.0	3.0	3.5
Residential Construction Inflation	3.0	3.3	2.9	[illegible]	2.3	3.1	2.8	4.3	3.7	3.9	2.0	2.6	3.8
Nonresidential Construction Inflation	4.4	[illegible]	2.8	[illegible]	3.8	4.3	3.1	3.2	3.0	0.3	3.0	2.9	3.0
Producers Price Inflation (WPI)	0.4	[illegible]	0.8	1.4	[illegible]	[illegible]	3.3	3.4	1.3	2.4	-0.2	0.2	1.3
Compensation per Manhour (% change)	3.3	1.8	[illegible]	3.3	3.8	3.3	3.7	3.1	4.8	4.2	3.6	3.3	4.4
Productivity (% change)	[illegible]	[illegible]	0.6	0.0	[illegible]	0.9	1.1	1.1	3.4	2.7	0.2	0.9	1.8
Unit Labor Cost (% change)	3.2	[illegible]	3.4	3.3	3.8	2.7	4.3	[illegible]	1.3	1.4	3.4	2.5	2.6
Before Tax Corporate Profits ($ billions)(2)	223	216	222	223	218	218	224	230	207	243	223	220	250
Corporate Tax Liability	88	81	81	83	83	82	85	89	56	78	87	84	100
After Tax Profits	137	136	137	133	133	136	139	141	147	146	137	136	150
Inventory Valuation Adjustment	3	6	3	3	4	3	9	12	11	8	2	5	13
Capital Consumption Adjustment	73	81	83	86	87	86	86	82	33	56	79	85	78
Profits from Current Production (with IVA, CCA)	219	224	224	233	218	219	230	211	149	190	217	218	215
Adjusted for Inflation (85:1 base)	212	221	218	210	210	209	208	194	159	201	215	209	200
Percent Change - Year Ago	8.2	8.1	1.0	1.8	1.1	3.3	3.8	8.8	48.0	26.3	7.0	-2.9	-4.4
Per Unit of Output (% of GNP)	5.6	5.7	5.6	5.4	5.4	5.0	5.2	5.0	4.5	5.5	5.6	5.3	5.0
Effective Corporate Tax Rate (%)(2)	38	33	33	33	33	33	38	24	34	32	28	37	31
Federal Tax Receipts (Unified basis)	826	725	683	677	821	760	737	780	533	683	737	768	835
Percent of GNP	21.4	18.9	17.3	16.8	20.1	18.5	17.8	18.6	18.6	18.7	19.0	18.9	19.2
Federal Expenditures (Unified basis)	936	924	985	968	967	946	1,006	1,016	803	868	942	977	1,047
Percent of GNP	24.3	23.6	24.7	24.1	23.9	22.9	24.2	24.0	24.3	23.7	24.2	23.8	23.7
Surplus or Deficit (Unified basis)	-110	-179	-292	-291	-146	-186	-266	-186	-196	-184	-205	-208	-212
% of GNP	-2.8	-4.6	-7.4	-7.2	-3.6	-4.4	-6.5	-4.5	-5.8	-5.0	-5.2	-4.9	-4.6
% of Personal Savings	78.7	228.4	181.7	282.0	140.2	133.5	245.5	218.7	158.1	117.2	194.1	179.9	151.8
% of Net Domestic Savings	34.4	68.0	102.2	101.8	18.2	22.5	100.3	98.6	80.0	56.3	70.1	70.3	65.7

(1) Includes personal contributions for social insurance.

(2) Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 2

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85.2	85.3	85.4	86.1	86.2	86.3	86.4	87.1	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (Thousands) (Single-family resales and completions)	4,089	4,382	4,401	4,301	4,381	4,428	4,502	4,533	3,750	3,936	4,227	4,403	4,521
Percent Change -- Year Ago	9.8	11.2	13.0	8.0	7.1	1.5	2.1	3.4	47.4	5.0	7.4	4.2	2.7
Existing Single-Family Home Sales (Thousands)	3,042	3,380	3,282	3,217	3,294	3,307	3,346	3,184	2,716	2,866	3,165	3,301	3,401
Percent Change - Year Ago	4.5	23.6	16.7	9.6	8.1	-1.6	2.0	3.9	36.5	5.5	10.4	4.3	3.0
Dollar Volume (Billions)	275.9	320.9	294.4	293.0	300.2	305.0	300.7	307.1	224.2	247.1	285.4	299.7	314.6
Existing Home Prices - Median ($1000's)	75.5	76.1	75.1	76.1	75.8	79.2	77.5	78.6	69.8	72.3	75.2	77.6	80.5
Percent Change - Year Ago	3.4	4.5	4.4	5.1	1.4	3.7	3.2	3.3	3.7	3.3	4.0	3.3	3.8
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	654	636	628	632	611	615	586	594	628	680	644	606	619
Percent of Median Family Income	29	28	28	27	26	26	25	25	32	32	29	26	25
Private Housing Starts (Thousands)	1,756	1,664	1,808	1,698	1,776	1,831	1,892	1,886	1,703	1,766	1,760	1,800	1,850
Percent Change - Year Ago	-4.6	0.3	13.1	5.4	0.2	10.3	4.6	11.1	61.0	3.8	-0.4	2.3	2.8
Single-Family	1,077	1,033	1,154	1,077	1,121	1,155	1,192	1,185	1,066	1,103	1,096	1,136	1,154
Percent of Total	60.7	62.1	63.8	63.4	63.1	62.9	63.0	62.8	62.6	62.4	62.3	63.1	62.4
Multi-Family	687	631	654	621	655	681	700	702	637	664	664	664	696
Percent of Total	39.1	37.9	36.2	36.6	36.9	37.1	37.0	37.2	37.4	37.6	37.7	36.9	37.6
Mobile Home Shipments	291	284	288	282	286	288	289	289	296	295	284	286	286
New Single-Family Home Sales (Thousands)	657	706	719	734	740	750	763	773	629	637	686	748	760
Percent Change - Year Ago	3.8	13.0	10.5	8.2	12.5	6.3	6.5	5.3	30.3	1.3	7.8	9.0	1.6
New Home Prices - Median ($1000's)	83.9	81.8	82.9	85.5	86.1	87.1	88.3	89.4	75.5	80.0	83.1	86.6	91.1
Percent Change - Year Ago	4.3	1.8	4.4	2.8	1.8	3.3	5.2	5.0	8.9	6.0	4.2	3.9	5.1
New Home Prices -Mean ($1000's, Quality Adjusted)	97.6	96.5	96.7	97.5	98.2	98.7	99.3	100.4	89.7	93.7	95.8	98.4	102.1
Percent Change - Year Ago	2.4	2.1	2.8	2.4	2.7	2.6	2.6	3.0	2.3	4.5	2.4	2.8	3.7
NAR Affordability Index	90.6	93.4	94.3	96.5	97.6	99.8	102.2	103.2	82.0	86.2	93.2	98.1	100.7
Mortgage Debt Outstanding ($ Billions)	2,154	2,218	2,291	2,437	2,520	2,606	2,680	2,768	1,753	1,933	2,212	2,570	2,894
Homeowners' Equity ($ Billions)	2,233	2,260	2,271	2,285	2,294	2,301	2,316	2,336	2,220	2,238	2,251	2,299	2,382
Housing Inventory (Millions)	95.7	96.1	96.5	96.9	97.2	97.5	98.1	98.5	92.7	94.4	95.9	97.5	99.1
Rental Vacancy Rate (1)	6.1	5.9	5.8	[illegible]	5.8	5.9	6.0	6.0	5.6	5.8	6.0	5.9	6.0
Office Vacancy Rate (1)	[illegible]	[illegible]	[illegible]	14.8	14.2	[illegible]	13.8	14.0	11.7	13.9	15.5	14.2	13.6
Industrial Vacancy Rate (1)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	3.8	3.8	4.9	4.7	4.5	4.1	3.5
New Commercial Building Construction (% CH Value)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	-4.1	11.7	24.7	-9.5	-0.4
New Industrial Building Construction (% CH Value)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	15.2	5.9	12.7	-4.7	14.3
FINANCIAL MARKETS													
Money Supply													
M1 (% Change)(1985 Target 3-8%)	[illegible]	13.8	4.1	3.4	3.6	4.7	4.8	4.9	11.1	6.9	8.7	7.0	5.1
M1 Velocity (% Change)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	-3.2	3.7	-3.1	-1.9	1.1
M2 (% Change)(1985 Target 6-9%)	[illegible]	10.6	5.5	6.2	4.6	7.8	7.9	8.5	11.9	7.9	9.0	7.2	6.6
M2 Velocity (% Change)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	-4.4	2.7	-2.6	-2.0	-0.4
Monetary Base (% Change)	9.3	8.8	7.1	5.3	4.5	4.1	4.8	4.8	8.7	8.1	7.2	5.7	4.7
Flow of Funds (NIA Basis)													
Sources (Total gross savings)	580	[illegible]	583	611	586	597	590	599	438	553	591	587	631
Private													
Personal Savings	100	78	104	111	111	110	115	120	118	156	130	115	131
Savings Rate	[illegible]	[illegible]	3.4	4.0	4.1	4.1	4.0	4.1	5.0	6.1	4.1	4.0	4.3
Gross Business Savings	[illegible]	[illegible]	517	518	501	502	500	501	434	519	501	503	539
Government													
Federal	-214	-200	-195	-181	-178	-173	-174	-183	-179	-176	-195	-177	-171
State and Local	50	47	46	43	44	46	45	37	44	53	49	46	37
Foreign (current account deficit)	117	119	126	122	121	102	120	119	41	102	113	121	116
Uses (Total gross investment)	647	[illegible]	669	671	612	674	690	694	471	638	643	679	731
Nonresidential Investment													
Equipment	294	302	298	311	299	301	309	315	233	273	296	302	315
Structures	168	167	169	165	166	166	166	168	130	150	167	167	173
Residential Investment	158	161	161	165	167	170	175	182	151	154	160	169	183
Inventory Investment	18	19	41	41	42	39	38	31	-7	58	21	41	44
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year Fixed Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	13.4	14.5	12.1	11.4	11.7
Real Mortgage Rate (30 yr. avg. in % (1))	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	10.1	10.9	9.1	9.3	8.1
1 Year ARM (without Buy-Down)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	11.9	12.8	10.2	9.2	9.9
Real Mortgage Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	7.9	9.0	8.1	6.8	6.2
Corporate Bond Rate (AAA)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	9.8	9.8	12.0	12.7	11.3	10.1	10.0
Government Bond Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	10.9	12.5	11.1	9.4	9.3
Real Government Bond Rate (10 yr. avg. in % (1))	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	7.6	9.4	7.1	6.8	5.7
Federal Funds Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	8.4	[illegible]	9.1	10.2	8.1	7.2	7.8
3 Month Treasury Bill Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	6.8	6.8	[illegible]	8.6	9.5	7.5	6.8	7.3
Real 3 Month T-Bill Rate (10 yr. avg in % (1))	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.8	[illegible]	4.8	5.9	3.6	4.2	1.8
1 Year Treasury Bill Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	9.6	10.9	8.3	7.7	8.2
Real 1 Year T-Bill Rate (10 yr. avg in % (1))	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	4.5	[illegible]	5.8	7.0	4.6	5.1	4.5
Commercial Paper Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	8.9	10.1	8.0	7.7	7.8
Rate on Money Market Fund Shares	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	8.0	10.1	8.0	7.2	7.9
Prime Rate	[illegible]	[illegible]	[illegible]	[illegible]	8.8	8.8	[illegible]	[illegible]	10.8	12.0	9.9	9.0	9.5

(1) Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Jannemarie Holley.

Special Supplement

The Continuing Saga of Tax Reform

Yet another tax reform proposal has surfaced in the Nation's capital--the Rostenkowski proposal. This plan for sweeping overhaul of our tax laws was prepared by the staff of the Joint Committee on Taxation at the request of Congressman Rostenkowski (D-IL), Chairman of the House Ways and Means Committee, and is serving as the basis for the mark-up of a tax reform bill in the Committee. We will present our analysis of the original proposal, however, it should be noted that when and if a tax bill is sent to the floor of the House it will likely be quite different than this original proposal.

Conceptually, the Rostenkowski proposal is very similar to the Reagan proposal introduced last May. Each would cut personal and corporate tax rates while limiting or repealing many personal and business deductions so as to raise roughly the same amount of revenue as current law. The net impact of these changes is a cut in personal taxes financed through an increase in taxes on investment, particularly long-life assets such as real estate. As a result, there is a shift in the composition of GNP toward consumption and away from investment. In the long run the effect of the lower level of investment compounds and results in slower growth of the economy and lower living standards for the typical family.

Owner-Occupied Homes

Table 1 presents a comparison of the provisions of current tax law which determine an individuals federal tax liability and the after-tax cost of both owner-occupied principal residences and second homes held for personal use with those same provisions under the Reagan and Rostenkowski proposals. Current law is expressed as it will be in 1986 when the zero bracket amount (ZBA) or standard deduction, exemptions, and tax brackets are indexed for inflation.

Under current law there are 14 personal marginal tax rates ranging from 11 percent to 50 percent. Under both the Reagan and Rostenkowski proposals there would be three personal marginal tax rates, 15 percent, 25 percent, and 35 percent, however, the taxable income brackets are somewhat different. The Reagan proposal would raise the taxpayer, spouse, and dependent exemptions from the current law $1,080 to $2,000 while the Rostenkowski proposal would raise those exemptions to $1,500. The Reagan proposal would raise the ZBA or standard deduction for joint returns from the current $3,670 to $4,000 while the Rostenkowski proposal would raise it to a base of $6,000. Under the Rostenkowski proposal the standard deduction would be raised by $500 for each dependent, raising the standard deduction for a joint return with two dependents to $7,000.

Table 1

Comparison of Individual Income Tax Provisions Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
PERSONAL MARGINAL TAX RATES	14 rate brackets from 11 to 50%	3 rate brackets 15%, 25%, 35%	3 rate brackets 15%, 25%, 35%
EXEMPTIONS			
Self, spouse	$1,080	$2,000	$1,500
Dependents	$1,080	$2,000	$1,500
Elderly	$1,080	Credit	Repealed
Blind	$1,080	Credit	Repealed
ZERO BRACKET AMOUNTS			
Single	$2,480	$2,900	$3,550[1]
Joint	$3,670	$4,000	$6,000[1]
Heads of Household	$2,480	$3,600	$4,275[1]
INDEXED RATE BRACKETS, EXEMPTIONS, AND ZBA	Yes	Yes	Yes
PERSONAL DEDUCTIONS			
Mortgage Interest			
Principal Residence	Yes	Yes	All personal interest deductions are limited to the *greater* of 1) interest on debt secured by principal residence, or 2) $20,000, plus passive investment income. (Expanded definition of interest subject to limit.[2])
Secondary Residence	Yes	Treated as other personal interest.	See above.
Other Personal interest	Yes Investment interest limited to $10,000 plus investment income.	Limited to $5,000 plus passive investment income. (Expanded definition of interest subject to limit.[2])	See above.

Table 1 (cont'd)

Comparison of Individual Income Tax Provisions
Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Real Property Taxes	Yes	No	Partially[3]
Personal Property Taxes	Yes	No	No
State and Local Income Taxes	Yes	No	Partially[3]
State and Local Sales Taxes	Yes	No	No
Medical Expenses	Yes, above 5% of AGI	Yes, above 5% of AGI	Yes, above 5% of AGI
Charitable Contributions	Yes, for itemizers and nonitemizers.	Deductible for itemizes but not for nonitemizers.	Deductible for itemizers but not for nonitemizers
Miscellaneous Deductions	Yes, for itemizers only	Yes, above 1% of AGI for itemizers and non-itemizers	Yes, above 1% of AGI for itemizers only
Two-Earner Deduction	Yes, 10% of lower salary	No	No
Child Care Credit	Yes	Yes	Yes, increased
FRINGE BENEFITS			
Health Insurance	Not taxed	First $120 of premiums per year for individual coverage and $300 for family coverage taxed.	Premiums above $120 per month for individual coverage and $300 per month for family coverage would be taxed.
Group-Term Life Insurance Premiums	Premiums for insurance over $50,000 taxed.	Premiums for insurance over $50,000 taxed.	Taxed
Dependent Care Assistance	Not taxed	Not taxed	Taxed

Table 1 (cont'd)

Comparison of Individual Income Tax Provisions
Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
OTHER INDIVIDUAL ITEMS			
Rollover of Capital Gains on Principal Residence	Capital gain tax deferred if seller purchases another residence costing at least as much as the one sold within two years.	Same as current law.	Same as current law.
One-time Exclusion on Capital Gains on Principal Residence	One-time exclusion of gain up to $125,000 on sale of principal residence for taxpayers 55 or older.	Same as current law.	Same as current law.
Income Averaging	Yes	No	No
MUNICIPAL BONDS			
Mortgage Revenue Bonds (MRBs)	Tax-exempt, volume restrictions.	Taxed	Tax-exempt, with greater targeting toward lower income individuals and more restrictive volume limitations.

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[1] These amounts are raised by $500 for each dependent and for elderly and blind taxpayers.

[2] Included in the definition of interest subject to limitation is the taxpayer's share of all interest expense of S corporations in which the taxpayer is not actively engaged in management and the taxpayer's distributive share of all interest expense of limited partnerships in which the taxpayer is a limited partner.

[3] Allowed deduction would be the greater of $1,000 for joint return, $500 for unmarried taxpayers, or the amount in excess of 5% of AGI.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

While the impact of these changes is to lower tax liability, another impact is to raise the after-tax cost of owner-occupied homes by reducing the value of itemized deductions. The reduction in marginal tax rates directly reduces the value of all itemized deductions so that a given dollar amount of deductions results in a reduced amount of tax savings. For example, where $1 of itemized deduction results in $.25 of tax savings with a 25 percent marginal rate, tax savings are reduced to $.15 with a 15 percent marginal rate. Increasing the ZBA or standard deduction also reduces the value of a given dollar amount of itemized deductions since it is the amount of such deductions above the ZBA which reduces taxable income and results in tax savings. Finally, increasing the value of exemptions tends to reduce the value of itemized deductions since, for a given level of gross income, larger exemptions result in lower taxable income and so are likely to result in a lower marginal tax rate.

In addition to reducing their value, both the Reagan and Rostenkowski proposals would reduce the dollar volume of deductions by repealing or limiting several currently allowed deductions. Under current law taxpayers are allowed unlimited deductions for interest paid on mortgages, auto loans, and other consumer interest while investment interest (interest on loans to purchase stocks, bonds, land and other so-called passive investments) is limited to $10,000 plus investment income. Under the Reagan proposal deductions for mortgage interest on a principal residence would remain unlimited. However, all other personal interest deductions would be limited to $5,000 plus investment income. The interest subject to this cap would include mortgage interest on a second home held for personal use, interest on auto loans, education loans, credit card balances, and investment interest. Further, a limited partner's pro rate share of the interest expense of a limited partnership would be included in the definition of investment interest. Currently, this limit on other personal interest deductions would not be binding for the majority of taxpayers. Average non-mortgage interest deductions for itemizing taxpayers with gross incomes of $21,500, $36,000, and $64,000 are roughly $800, $1,100, and $2,100, respectively. However, this interest deduction limit could be seriously binding for taxpayers who are paying interest on a mortgage to purchase a second home held for personal use. Moreover, this interest deduction limit would get progressively more restrictive over time as the $5,000 limit is not indexed for inflation or fluctuations in interest rates.

The Rostenkowski proposal would limit deductions of all personal interest, including mortgage interest on a principal residence, to the greater of interest on debt secured by the taxpayer's principal residence or $20,000, plus investment income. As with the Reagan proposal a limited partner's share of the interest expense of a limited partnership would be included in the definition of investment interest. Again, this formula would not limit interest deductions for the majority of taxpayers at current interest rates and home prices. For example, a taxpayer with a gross income of $64,000 who purchased a $150,000 home with a 20 percent downpayment and a $120,000 mortgage with a 13 percent interest rate would have mortgage interest of about $15,600 plus non-mortgage interest deductions of about $2,100 for a total of $17,700. As with the approach in the Reagan proposal, the Rostenkowski proposal would get more restrictive over time as home values rise and during periods of high interest rates since the $20,000 figure is not indexed for inflation or interest rates. Further, the $20,000 limit could be binding on middle-income taxpayers who had mortgage interest on a second home held for personal use.

While not binding on most taxpayers, the Rostenkowski formula is conceptually quite different from the Reagan approach and should be viewed as an assault on the traditional sanctity of principal residence mortgage interest deductibility. The reason is that a taxpayer with principal mortgage interest of less than $20,000 but total interest deductions in excess of $20,000 would find that any additional principal residence mortgage interest would not be deductible. For example, a taxpayer who purchased a $175,000 home with a 20 percent downpayment and a $140,000 mortgage at 13 percent would have first-year interest of about $18,000. Such a taxpayer is likely to have about $2,500 of non-mortgage interest deductions. The total of $20,500 of interest deductions would exceed the $20,000 limit and so $500 of interest would be nondeductible. Under these circumstances an additional dollar of mortgage interest, due either to higher interest rates or a larger mortgage amount, would not increase the total amount of allowable interest deductions.

The Reagan proposal would repeal deductibility of all state and local taxes including income taxes, real property taxes, sales taxes, and personal property taxes. This clearly would raise the after-tax cost of owner-occupied homes as well as tend to raise the tax liability of taxpayers who itemize. Under the Rostenkowski proposal deductibility of state and local sales and personal property taxes would also be repealed. However, state and local income and real property taxes would be deductible up to the greater of (1) $1,000 or (2) the amount of such taxes in excess of 5 percent of adjusted gross income (AGI). While this formula does provide some deductibility of these taxes, it should be noted that state and local income taxes would absorb virtually all of the allowed deductibility. For example, as shown in Table 2 the average state and local income tax deduction for an itemizing taxpayer with an AGI of $36,000 would be about $1,300. If this taxpayer owned an $85,000 home (a $36,000 income would be the minimum income required to purchase an $85,000 home with a 20 percent downpayment at current interest rates) the real property tax deduction would be about $1,200. The maximum deduction this taxpayer could take is $1,000 as the amount of deductible taxes in excess of five percent of AGI is about $700. This $1,000 of deductibility is totally accounted for by the state and local income tax which this taxpayer would have paid even if he were a renter. As a result, the effective real property tax deduction is zero.

The Reagan and Rostenkowski proposals would make several other important changes to current law. Both would repeal the current 10 percent two-earner deduction and income averaging. Miscellaneous deductions would be limited to the amount in excess of one percent of AGI, while the Reagan proposal would allow this deduction for non-itemizers as well as itemizers. Deductions for charitable contributions by non-itemizers would be repealed. Both proposals would further expand the tax base by including in gross income a small amount of employer paid fringe benefits, although the approaches taken are significantly different. For health insurance, the Reagan proposal would tax the first $120 per year of employer-paid premiums for individual coverage and the first $300 per year for family coverage. In contrast, the Rostenkowski proposal would tax premiums above $120 per month for individual coverage and $300 per month for family coverage. Further, the Rostenkowski proposal would tax all employer-paid life insurance premiums while the Reagan proposal would retain current law where premiums for insurance over $50,000 are taxed.

Table 2

Analysis of State and Local Income and Real Property Tax Deductibility Under the Rostenkowski Proposal

AGI	$21,500	$36,000	$ 64,000
Home Value	$50,000	$85,000	$150,000
State and Local Income Tax[1]	$ 700	$ 1,300	$ 2,600
Real Property Tax[2]	$ 715	$ 1,216	$ 2,145
Total	$ 1,415	$ 2,516	$ 4,745
5% of AGI	$ 1,075	$ 1,800	$ 3,200
Excess	$ 340	$ 716	$ 1,545
Maximum Deduction	$ 1,000	$ 1,000	$ 1,545
Effective Property Tax Deduction	$ 300	0	0

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[1] SOURCE: 1983 Statistics of Income—Individual Income Tax Returns.

[2] According to the U.S. Advisory Commission on Intergovernmental Relations the weighted-average effective property tax rate for single-family homes is 1.43 percent.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Specific to owner-occupied housing, both proposals would retain the current rollover of capital gains on the sale of a principal residence and the $125,000 one-time exclusion of gain on the sale of a principal residence by taxpayers 55 or older. However, the Reagan proposal would repeal the tax exempt status of mortgage revenue bonds (MRBs). Under the Rostenkowski proposal MRBs would remain tax-exempt but would be targeted more toward lower income individuals while more restrictive volume limitations would be imposed.[1] [2]

Table 3 presents estimated impacts of both the Reagan and Rostenkowski proposals on the after-tax cost and the market value of owner-occupied homes. Estimates are provided for three home prices--$50,000, $85,000 and $150,000. All tax calculations are based on the minimum income required to purchase such a home assuming current interest rates and industry-wide lending criteria. Due to the loss of property tax deductibility under both proposals, and the reduced value of the mortgage interest deduction resulting from the lower marginal tax rates and the increased ZBA, the after-tax cost of ownership of principal residences would rise significantly under both proposals. The annual after-tax cost of an $85,000 home would rise by $1,241 or 16 percent under the Reagan proposal and by $1,525 or 20 percent under the Rostenkowski proposal. The larger increase under the Rostenkowski proposal is primarily due to the $3,000 larger ZBA under that proposal. The percentage increase in the annual after-tax cost of the $50,000 home would be less under both proposals since the decline in marginal tax rates at that income level would be relatively smaller. (See Appendices A, B, and C for greater detail).

The rise in the after-tax cost of owner-occupied homes would diminish their affordability to potential buyers and therefore make them worth less in the marketplace. Under the Reagan proposal the value of an $85,000 home is likely to fall by 14 percent or about $12,000 while under the Rostenkowski proposal the decline in value is likely to be 17 percent or nearly $15,000. The percentage decline in value would be somewhat less for lower priced homes since the percentage increase in after-tax cost would be somewhat less. The decline in home values will vary from state to state as property tax rates vary significantly.[3] (See Appendix D for state detail).

It is important to note that, contrary to what some advocates of tax reform have asserted, a decline of home values due to these proposed changes in tax law would not benefit first-time buyers or current homeowners who would like to upgrade their housing. For example, under current law the annual after-tax cost of an $85,000 home is about $7,760 or about $650 per month. Under the Reagan proposal that after-tax cost would rise to about $9,000 or $750 per month. This increase in after-tax cost is likely to prompt a decline in value such that the after-tax cost under the new tax system would be roughly equal to what it is under current law. Thus, the 14 percent decline in value to about $73,000 would cause the after-tax cost to fall back to $650 per month. The point is that regardless of whether the home costs $85,000 under current law or $73,000 under the Reagan proposal, it is still going to cost the homebuyer $650 per month after-tax to own the home.

Table 3

Comparison of After-Tax Homeownership Costs Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal[1]
(Mortgage Rates Unchanged)

EXAMPLE #1

Cost of Home - $50,000
Required Income - $21,500

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Before Tax Cost ($)	$5,915	$5,915	$5,915
Marginal Tax Rate (%)	16%	15%	15%
Tax Savings ($)	868	470	189
After Tax Cost ($)	5,047	5,445	5,726
Change in Cost ($)	—	+398	+679
Change in Cost (%)	—	+8%	+13%
Change in Home Value (%)	—	-8%	-13%

EXAMPLE #2

Cost of Home - $85,000
Required Income - $36,000

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Before Tax Cost ($)	$10,056	$10,056	$10,056
Marginal Tax Rate (%)	25%	15%	15%
Tax Savings ($)	2,298	1,057	773
After Tax Cost ($)	7,758	8,999	9,283
Change in Cost ($)	—	+1,241	+1,525
Change in Cost (%)	—	+16%	+20%
Change in Home Value (%)	—	-14%	-17%

EXAMPLE #3

Cost of Home - $150,000
Required Income - $ 64,000

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Before Tax Cost ($)	$17,745	$17,745	$17,745
Marginal Tax Rate (%)	38%	25%	25%
Tax Savings ($)	5,,908	3,900	3,588
After Tax Cost ($)	11,837	13,845	14,157
Change in Cost ($)	—	+2,008	+2,320
Change in Cost (%)	—	+17%	+20%
Change in Home Value (%)	—	-15%	-17%

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[1] All examples assume a 20 percent downpayment, a 30 year fixed rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Required income assumes 25 percent of income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

It is also important to put this potential decline in home values in perspective. Statistics compiled by the Federal Reserve Board indicate that the total stock of owner-occupied homes in this country has a value of roughly $3.5 trillion.[4/] An average decline of value of between 14 and 17 percent would represent an aggregate loss of wealth of between $500 billion and $600 billion. The bulk of the net worth of the typical family is the equity they have in their home. Since the average amount of homeowner's equity represents about 70 percent of the home value, the decline in home values would destroy 20 percent to 25 percent of the typical families life savings.

There has been some confusion over the potential decline in home values due to tax revision as many people are under the impression that even though the after-tax cost of owning a home would rise, the homeowner's overall federal tax burden would fall. Thus, the argument is frequently made that with more of their gross income at their disposal homebuyers could afford to pay the increased costs of homeownership and home values would be maintained. Analysis reveals, however, that the federal tax burden on homeowners is more likely to rise under both the Reagan proposal and the Rostenkowski proposal than it is to fall. This result is due to the fact that homeowners, particularly recent homeowners, tend to itemize deductions and the loss in both the amount of deductions and their value overwhelms the impact of lower tax rates and the higher personal exemption.

Table 4 presents comparisons of the federal tax liability of a one-earner family of four and a two-earner family of four under current law, the Reagan proposal, and the Rostenkowski proposal. Comparisons are between recent homeowners and renters at income levels of $21,500, $36,000, and $64,000 which correspond to the income levels and home values used in Table 3. In nearly all cases the homeowner's tax burden rises, particularly in the case of two-earner families who would lose the two-earner deduction, while the tax burden of renters at the same income level would decline. For example, at the $36,000 income level which corresponds to the average sales price of $85,000, a recent homeowner's tax burden would rise by $67 or 2.7 percent under the Reagan proposal for the one-earner case and by $174 or 8.2 percent for the two-earner case. For a renter at the same income level and the same amount of non-housing itemized deductions, tax burden under the Reagan proposal would decline by $1,174 or 24.4 percent of the one-earner case and decline by $1,025 or 23.5 percent for the two-earner case. Under the Rostenkowski proposal the increase in the homeowners tax burden and the decline in the renters tax burden tend to be even greater due primarily to the larger increase in ZBA. (See Appendix E for greater detail).

To further support the conclusion that the Reagan and Rostenkowski proposals are likely to depress home values, Table 5 combines the increase in after-tax homeownership costs with the decline in disposable income or increased tax liability of the typical recent homebuyer to see what impact these proposals would have on after-tax homeownership costs as a percent of disposable income. Under current law the after-tax cost of an $85,000 home would absorb about 23 percent of the disposable income of a recent homebuyer with a gross income of $36,000. If home values were to remain unchanged, that percentage would have to rise to about 27 percent of disposable income under the Reagan proposal and about 28 percent under the Rostenkowski proposal. It is unlikely that homebuyers would be willing to devote an additional 4 to 5 percent of their after-tax income for the same quantity of housing services. Further, given the current concern over foreclosures, it is unlikely that mortgage lenders and insurers would be willing to relax their underwriting criteria to allow consumers to devote those additional amounts of their disposable income to housing costs.

Table 4

Impact of the Reagan and Rostenkowski Proposals on the Federal Tax Liabilities of Homeowners and Renters with Equal Incomes[1]

		Family Income					
		$21,500		$36,000		$64,000	
		Homeowner	Renter	Homeowner	Renter	Homeowner	Renter
One-Earner Family of Four[2]							
Current Law		$ 997	$1,865	$ 2,505	$4,803	$ 6,783	$12,691
Reagan Proposal		981	1,451	2,572	3,629	6,629	10,529
Change from	$	-16	-414	+67	-1,174	-154	-2,162
Current Law:	%	-1.6%	-22.2%	+2.7%	-24.4%	-2.3%	-17.0%
Rostenkowski Proposal		1,086	1,275	2,677	3,450	6,432	10,020
Change from	$	+89	-590	+172	-1,353	-351	-2,671
Current Law:	%	+8.9%	-31.6%	+6.9%	-28.2%	-5.2%	-21.0%
Two-Earner Family of Four[3]							
Current Law		$ 662	$1,522	$ 2,113	$4,369	$ 5,969	$11,952
Reagan Proposal		695	1,165	2,287	3,344	6,308	10,208
Change from	$	+33	-357	+174	-1,025	+339	-1,744
Current Law:	%	+5.0%	-23.5%	+8.2	-23.5	+5.7%	-14.6%
Rostenkowski Proposal		800	989	2,392	3,165	6,111	9,699
Change from	$	+138	-533	+279	-1,204	+142	-2,253
Current Law:	%	+20.8%	-35.0%	+13.2%	-27.6%	+2.4%	-18.9%

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[1] Mortgage interest and property tax deductions for families with incomes of $21,500, $36,000, and $64,000 are based on homes costing $50,000, $85,000 and $150,000, respectively. The mortgage interest deduction is the first year interest on an 80 percent loan-to-value ratio loan with an interest rate of 13 percent. The property tax deduction is 1.43 percent of property value. All non-deductions, according to the 1983 Statistics of Income--Individual Income Tax Returns. Renters are assumed to have the same level of these deductions as homebuyers.

[2] Child-care credit not used.

[3] Income of family is split two-thirds, one-third between the two earners. Two-earner deduction and child-care credit are used.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

Table 5

After-tax Homeownership Costs of an $85,000 Home as a Percent of Disposable Income Under Current Law, the Reagan Proposal and the Rostenkowski Proposal

	Current Law	Reagan Proposal	Rostenkowski Proposal
AGI	$36,000	$36,000	$36,000
Tax Liability[1]	2,505	2,572	2,677
Disposable Income	33,495	33,428	33,323
After-tax cost of Homeownership[2]	7,758	8,999	9,283
Percent of Disposable Income	23.2%	26.9%	27.9%
Change from Current Law (percentage points)	--	3.7%	4.7%
(percent)	--	16%	20%

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[1] Based on the one-earner case.

[2] Based on an $85,000 home purchased with a 20 percent downpayment and a 30-year, fixed-rate mortgage at 13 percent, and property taxes equal to 1.43 percent of the property value.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

MRB Financed Homes

Over the past four years over 500,000 lower-priced homes have been purchased with the aid of tax-exempt mortgage revenue bonds (MRBs). Since the income yielded to investors in these bonds is exempt from federal taxation, investors are willing to accept yields significantly below the yields provided by comparable assets which generate taxable income. This allows mortgage funds to be lent to low- and moderate-income homebuyers at about 2 1/2 percentage points below the going market rate.

The repeal of the tax-exempt status of MRBs under the Reagan proposal and the more restrictive volume limitations under the Rostenkowski proposal represent a special case in terms of impact on after-tax homeownership costs. Potential homebuyers who otherwise would have relied on MRB financing would confront not only the increase in after-tax cost due to lower marginal tax rates, the increase in the ZBA, and the total or partial loss of property tax deductibility but also the increase in after-tax cost due to the loss of the below-market interest rate. Table 6 presents an example of a $50,000 home with MRB financing at 2 1/2 percentage points below the market rate. Under current law the annual after-tax cost would be roughly $4,200. Under the Reagan proposal the after-tax cost would rise by about $1,250 or 30 percent while under the Rostenkowski proposal the after-tax cost would rise by about $1,540 or 37 percent.

Table 6

Impact of the Loss of MRB Financing and the Reagan and Rostenkowski Proposals on the After-Tax Cost of a $50,000 Home[1]

	Current Law	Reagan Proposal	Rostenkowski Proposal
Before-Tax Cost	$4,915	$5,915	$5,915
Mortgage Interest	5,200	5,200	5,200
MRB Savings	-1,000	--	--
Property Taxes	715	715	715
Marginal Tax Rate	16%	15%	15%
Tax Savings	728	470	189
Mortgage Interest	770	470	179
MRB Savings	-148	--	--
Property Tax	106	--	10
After-Tax Cost	4,187	5,445	5,726
Change: $	--	1,258	1,539
%	--	30%	37%

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[1] Example assumes a joint tax return with AGI of $21,500 and with four exemptions. Home is financed with a 20 percent downpayment and a fixed-rate, 30-year mortgage for the remaining 80 percent of the purchase price. MRB financing is at 10.5% while conventional financing is at 13%. Property taxes are 1.43 percent of the home value.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Second Homes Held for Personal Use

Second homes held for personal use represent another special case since, in addition to losing property tax deductibility, it is likely that some or all interest deductibility would also be lost due to the limitations on deductibility of personal interest other than mortgage interest on a principal residence included in both the Reagan and Rostenkowski proposals. It is important to note that we are concerned here only with second homes held for personal use. Second homes which are held as rental properties fall under the tax rules of property used in a trade or business.

Table 7 presents an example of the potential increase in after-tax cost of a typical second home under both the Reagan and Rostenkowski proposals.[5/] It is safe to conclude that property taxes would not be deductible under the Rostenkowski proposal since as shown in Table 2, allowed deductions would likely be completely used up by state and local income taxes even for those taxpayers who found it advantageous to elect the excess over 5 percent of AGI option. It is less certain as to the amount of second home mortgage interest that would be deductible since that will depend upon the individual circumstances of each taxpayer. For that reason, Table 7 presents a range of potential impacts on after-tax cost from Case I, where all mortgage interest is deductible, to Case III where none is deductible. The example suggests that even in the best of circumstances the after-tax cost is likely to increase by 26 percent. To the extent that mortgage interest is not deductible the increase in after-tax cost increases. In the worst possible case, where none of the second home mortgage interest is deductible, the after-tax cost rises by 61 percent and equals the before-tax cost.

Table 7

Impact of the Reagan Proposal and the Rostenkowski Proposal on a Typical $60,000 Second Home[1]

	1986 Current Law	Tax Revision Case I	Case II	Case III
Before-Tax Cost	$7,098	$7,098	$7,098	$7,098
Mortgage Interest	6,240	6,240	6,240	6,240
Property Tax	858	858	858	858
Marginal Tax Rate	38%	25%	25%	25%
Tax Savings	2,697	1,560	780	0
Mortgage Interest	2,371	1,560	780	0
Property Tax	326	--	--	--
After-Tax Cost	4,401	5,538	6,318	7,098
Change in Cost (%)		+26%	+44%	+61%
Change in Cost ($)		+1,137	+1,917	+2,697
Change in Value (%)		-22%	-28%	-38%

Case I: All mortgage interest is deductible since dividend and interestincome raises the limit on interest deductions so that it is notbinding on the taxpayer.

Case II: Only half ($3,120) of mortgage interest is deductible due to the limit on personal interest deductions.

Case III: No mortgage interest is deductible due to the limit on personal interest deductions.

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[1] This table assumes a $60,000 second home purchased with a $12,000 downpayment and a $48,000 mortgage at 13 percent resulting in about $6,240 of mortgage interest the first year. Property taxes are assumed to be 1.43 percent of the property value or $858. The buyer is assumed to have a $70,000 adjusted gross income, to file a joint return with 4 exemptions.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Commercial and Rental Residential Real Estate

Table 8 presents a side-by-side comparison of the main provisions of current tax law which affect the yields on investments in commercial and rental residential real estate with their status under both the Reagan and Rostenkowski proposals. While all of the proposed changes are important to some real estate investments and investors, there is a core of proposed changes which would impact virtually all real estate investments.

A) Maximum Marginal Tax Rate

Both the Reagan and Rostenkowski proposals would reduce the maximum marginal personal tax rate from 50 percent to 35 percent.

B) Depreciation

Under current law real property can be depreciated over 19 years using either the straight-line method or 175 percent declining balance method. Under the Rostenkowski proposal real property would be depreciated over 30 years using the straight-line method. The Reagan proposal would introduce inflation indexing with depreciation deductions equaling 4 percent of the inflation adjusted basis. As documented in Appendix F, depreciation deductions under both the Reagan and Rostenkowski proposals would be considerably less than under present law. For example, for the typical ten year holding period the present value of depreciation deductions under the Reagan proposal would be 35 percent less than current law while under the Rostenkowski proposal the present value of depreciation deductions would be 51 percent less than current law.

C) Capital Gains

Under current law 60 percent of the gain on capital assets is excluded from tax, with the remaining 40 percent taxed as ordinary income. (However, excluded gain is a tax preference item in the computation of the individual minimum tax). With a maximum marginal personal tax rate of 50 percent, the maximum capital gains tax rate is 20 percent which is 60 percent lower than the rate on ordinary income.

Under the Rostenkowski proposal the capital gains exclusion would be reduced to 40 percent. With a maximum marginal personal rate of 35 percent, the maximum capital gains tax rate would rise to 21 percent which is just 40 percent lower than the maximum rate on ordinary income.

Table 8

Comparison of Tax Provisions Impacting Commercial Real Estate Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Personal Marginal Tax Rates	14 rate brackets from 11% to 50%	3 rate brackets, 15%, 25%, 35%	3 rate brackets, 15%, 25%, 35%
Personal Deductions			
Interest	Unlimited deductibility except for interest incurred to carry investment property which is limited to $10,000 plus net investment income. Limited partner's share the interest expense of the partnership not subject to limit.	Unlimited deductibility of mortgage interest on principal residence. All other interest limited to $5,000 plus net investment income, including limited partner's share of the interest expense of the partnership.	All personal interest deductions, including the limited partner's share of the interest expense of the partnership, are limited to the greater of 1) interest on debt secured by principal residence, or 2) $20,000, plus net investment income.
Corporate Tax Rates	15% to 40% on first $100,000, 46% over $100,000. Flat rate of 46% at $1,405,000 or higher.	15% to 25% on first $75,000, 33% over $75,000. Flat rate of 33% at $345,000 or higher.	15% to 30% on first $75,000, 35% over $75,000. Flat rate of 35% at $350,000 or higher.
Depreciation			
General	19 years, 175% declining balance.	4% of inflation adjusted basis, 28 year closeout.	30 years, straight line.
Low-Income Rental Housing	15 years, 200% declining balance.	4% of inflation adjusted basis, 28 year closeout.	18 years, 150% declining balance.

Table 8 (cont'd)

Comparison of Tax Provisions Impacting Commercial Real Estate Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal		Rostenkowski Proposal
Depreciation subject to recapture as ordinary income				
Residential	Gain is recaptured only to the extent that accelerated depreciation deductions exceeds straight line deductions (Section 1250 recapture).	All gain on the disposition of depreciable property taxed as ordinary income.		All depreciation, to the extent of gain, recaptured as ordinary income.
Low-Income	Section 1250 recapture plus phase out of recapture at the rate of 1% a month after the property has been held for 100 months.	All gain on the disposition of depreciable property taxed as ordinary income.		All depreciation, to the extent of gain, recaptured as ordinary income.
Non-Residential	No recapture if depreciated using straight line method. If accelerated depreciation is used, all depreciation, to the extent of gain, is recaptured (Section 1245 recapture).	All gain on the disposition of depreciable property taxed as ordinary income.		All depreciation, to the extent of gain, recaptured as ordinary income.
Capital Gains				
		Depre/ciable Assets	Nondepre/ciable Assets	
Exclusion	60%	0	50%	40%
Basis indexed for inflation	No	Yes	No	No

Table 8 (cont'd)

Comparison of Tax Provisions Impacting Commercial Real Estate Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Construction Period Interest and Taxes	10 year amortization allowed.	Repealed. Added to real property basis.	Repealed. Added to real property basis.
Interest Expense	Fully deductible for property used in trade or business.	Same as current law. (Except for limited partners).	Same as current law. (Except for limited partners).
Investment Tax Credit	6%-10%	Repealed	Repealed
Rehabilitation Tax Credits	15% credit, with with full basis adjustment, for non-residential structures at least 30 years old.	Repealed	10% credit for buildings constructed before 1935.
	20% credit, with full basis adjustment, for nonresidential structures at least 40 years old.	Repealed	10% credit for buildings constructed before 1935.
	25% credit, with 50% basis adjustment, for certified historic residential and nonresidential structures.	Repealed	20% credit with full basis adjustment.
Section 167K Rules	Rehabilitation expenses for low-income housing can be amortized over 60 months.	Repealed	Retain current law with minor modifications.
Installment Sales	Taxation deferred until payments received.	No deferral if receivables pledged as collateral.	No deferral if receivables pledged as collateral.

Table 8 (cont'd)

Comparison of Tax Provisions Impacting Commercial Real Estate Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
"At-Risk" Rules	Real estate exempt. Cumulative losses may exceed the amount of equity plus recourse financing.	"At-Risk" rule extended to real estate. Cumulative losses limited to equity plus recourse financing.	"At-Risk" rule extended to real estate. Cumulative losses limited to equity plus recourse financing.
Industrial Development Bonds			
Multi-family Rental Housing	Tax exempt.	No tax exemption.	Tax-exempt, with greater targeting toward lower income individuals and with volume limitations.
Other	Tax-exempt, volume restrictions.	No tax exemption.	Tax exempt, but fewer uses qualify for exemption and more restrictive volume limitations.
Individual Alternative Minimum Tax			
Rate	20%	20%	25%
Exemption Amount	$40,000 for joint returns.	Sum of the following: 1) $15,000 for joint returns, 2) the first $10,000 of preferences, 3) the taxpayer's personal exemptions.	$40,000 for joint returns.
Real Estate Preferences			
Accelerated Depreciation on Real Property.	Excess of 19 years, 175% declining balance over 19 years straight-line.	For property placed in service beginning in 1986, excess of 4% of inflation adjusted basis, 28 year closeout, over 3% of inflation adjusted basis, 63 year closeout.	For property placed in service beginning in 1986, excess of 30 year straight-line over 40 year straight-line.
Net Capital Gain Deduction	Yes	Yes	Yes

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Commercial and Rental Residential Real Estate (cont'd)

Under the Reagan proposal a major distinction would be made between depreciable assets such as structures and nondepreciable assets such as land, stocks, and bonds. For nondepreciable assets a 50 percent exclusion would be retained while the asset basis would not be indexed for inflation. With a maximum marginal personal rate of 35 percent, the maximum capital gains tax rate would be 17 1/2 percent which would be 50 percent less than the maximum rate on ordinary income. For depreciable assets, there would be no exclusion. However, the amount of gain would be based on the inflation-indexed adjusted basis. Analysis indicates that if the asset appreciates at less than 3 1/2 percentage points above the overall inflation rate, the effective capital gains tax rate would be less than the 17 1/2 percent rate achieved with the 50 percent exclusion. However, if the property appreciates at more than 3 1/2 percentage points above the overall inflation rate, the effective capital gains tax rate is higher than that on nondepreciable assets. Consequently, above average real estate investments would be taxed at a rate greater than financial assets that appreciated at a similar rate.

Table 9

Comparison of Indexing versus 50% Exclusion Capital Gains Treatment[1/]

Overall Inflation Rate	Property Appreciation Rate	Tax Indexing	Tax Exclusion
5%	0%	-22,011	0
5%	5%	0	11,006
5%	8.5%	22,100	22,100
5%	10%	33,770	27,890
5%	15%	84,583	53,297

[1/] Example based on a $100,000 property held for 10 years by a taxpayer in the 35% bracket. For simplicity the effects of depreciation, property taxes, selling expenses and the alternative minimum tax, if any, are ignored.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

D) Depreciation Recapture

Under current law commercial real estate is subjected to Section 1245 recapture where if the structure is depreciated using the straight-line method no depreciation is subject to recapture as ordinary income. On the other hand, if the 175 percent declining balance method is used, all depreciation, to the extent of gain, is recaptured as ordinary income. Due to the more onerous recapture provision when accelerated depreciation is used, most commercial structures are depreciated using the straight-line method. Rental residential real estate is subject to Section 1250 recapture, where only depreciation in excess of straight-line is recaptured as ordinary income.

Under both the Reagan and Rostenkowski proposals, all depreciation, to the extent of gain, would be recaptured as ordinary income. However, there ~~is a major~~ distinction between the two since under the Reagan proposal gain would be based on an inflation-indexed adjusted basis whereas under Rostenkowski the adjusted basis would not be indexed.

E) At-Risk

Under current law real estate investments are exempt from the at-risk rule which limits the cumulative losses generated by an investment to the amount the investor is at risk, which has been defined as equity plus recourse financing or financing for which the investor has pledged collateral other than the asset in question. Mortgages tend to be nonrecourse loans meaning that the mortgaged property is the sole security for the loan. Real estate has been exempt from the at-risk rule because mortgage lenders have been willing to make nonrecourse loans. However, both the Reagan and Rostenkowski proposals would extend the at-risk rule to real estate.

F) Investment Interest Limitation

Under current law limited partners in a limited partnership have been generally regarded to be engaged in a trade or business so that their share of the interest expense of the partnership has not been subject to the existing limitation on personal deductions of investment interest. Both the Reagan and Rostenkowski proposals would include the limited partner's share of the interest expense of a partnership as investment interest deductions of which would be limited. For the most part, a limited partner's interest deductions would be limited to his share of the net investment income of the partnership, defined as net operating income less depreciation.

Table 10 presents the impacts of these six core proposals on yields provided by commercial and rental residential real estate investments. Impacts are presented for typical investments with 10 percent equity (90 percent loan-to-value ratio) and with 25 percent equity (75 percent loan-to-value ratio). Impacts are also differentiated between commercial real estate, where under current law the straight-line method tends to be used to depreciate real property, and for rental residential real estate, where the 175 percent declining balance (ACRS) method tends to be used. For this reason, the relative decline in yields tends to be greater for residential than for commercial. Several tendencies are evident. First, in all cases the Rostenkowski proposal results in a larger decline in yield than the Reagan proposal. Second, the relative decline in yield increases as the loan-to-value ratio increases. Finally, due to the interest deduction limitation, limited partners would experience a sharper decline in yield than would general partners or sole proprietors.

Declines in yields of this magnitude would undoubtedly cause a severe decline in investment in new commercial and rental residential real estate along with a significant decline in the value of existing structures. Over time the reduced rate of new investment will cause both commercial and residential rents to rise more rapidly than would otherwise be the case.

Table 10

Impact of the Reagan and Rostenkowski Proposals on Yields Provided by Commercial and Rental Residential Real Estate Investments

	Relative Decline in Yield[1]			
	10% Equity		25% Equity	
	Reagan[2] Proposal	Rostenkowski Proposal	Reagan[2] Proposal	Rostenkowski Proposal
Commercial[3]				
General Partner or Sole Proprietor[4]	-28.4%	-32.5%	-6.5%	-15.6%
Limited Partner[5]	-40.8%	-37.7%	-16.1%	-19.9%
Residential[3]				
General Partner or Sole Proprietor[4]	-40.1%	-43.6%	-14.7%	-23.0%
Limited Partner[5]	-50.4%	-47.8%	-23.5%	-27.0%

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[1] Yield is measured by 10-year after-tax internal rate of return (IRR), which is the discount rate at which the present value of all future after-tax benefits equals the initial equity investment.

[2] For purposes of indexing of capital assets and adjusted basis for inflation a rate of 5 percent is assumed.

[3] Assumptions underlying typical commercial and residential real estate investments:

Basis: $1,000,000 project acquired 1/1/86 with original basis allocated $150,000 to land, $50,000 to furniture, fixtures and equipment, and $800,000 to real property.

Current Law Real Property Depreciation: Commercial-19 years S.L.
Residential-19 years ACRS

Financing: A 30-year conventional mortgage at 13 % interest, evaluated at both 10% and 25% cash down.

Income and Expenses: Net operating income of $100,000 increasing at 5% per year.

Projected Value: Starting Value of $1,000,000 increasing at 5% per year.

Expenses of Sale: Selling expenses of 6% upon ultimate sale.

Ownership: Individual taxpayer(s) in a marginal tax bracket of 50% under current law.

[4] Impact on general partner or sole proprietor reflects reduction in the maximum marginal personal tax rate to 35 percent, changes in depreciation, capital gains, depreciation subject to recapture, and extension of the at-risk rule to real estate. Impact on limited partner adds to all of the above the limit on investment interest deductions. Interest deductions of the investment are limited to the net investment income of the investment, which is defined as net operating income less depreciation actually taken. Interest not deducted in any year is carried forward indefinitely.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Revenue Impacts

Table 11 presents estimates of the impact on federal revenues of several of the changes in tax law proposed in both the Reagan and Rostenkowski proposals. The estimates provide an interesting comparison between revenues to be gained or lost through various provisions both with a proposal and between proposals. For example, the total repeal of state and local tax deductibility under the Reagan proposal raises $148.9 billion over five years, nearly 62 percent of the revenues lost through personal rate reductions. In contrast, the Rostenkowski proposal relies much less on limiting state and local tax deductions to finance personal rate cuts. However, both proposals significantly shift the tax burden away from individuals and onto business. This is dubious policy for an economy already short on investment and struggling to compete in international markets.

Table 11

Selected Impacts of Tax Reform Proposals on Federal Revenues
(1986 to 1990, Billions of Dollars)

	Reagan Proposal[1]	Rostenkowski Proposal[2]
Individual Rate Reductions (including capital gains)	-$242.1	-$225.8
Corporate Rate Reductions (including capital gains)	-$153.4	-$99.0
Changes in deductibility of state and local taxes	$148.9	$64.9
Changes in depreciation schedules (equipment and structures)	$37.1	$50.7
Repeal Investment Tax Credit	$165.4	$114.2
Changes in tax treatment of Mortgage Revenue and Industrial Development Bonds	$13.0	$5.9
Changes in rehabilitation tax credits	$6.5	$2.6
Limitations on personal deductions of interest other than principal home mortgage interest	$3.1	$0.5
Extend at-risk rule to real estate	$0.2	$0.2
Changes in minimum tax	$4.2	$36.0
Individual	$1.3	$22.2
Corporate	$2.9	$13.8
Net Change in Receipts	$13.4	-$4.0
Individual	-$131.8	-$164.3
Corporate	$118.4	$160.3

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[1] Source: The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity, May 1985, Appendix C, pp. 453-461.

[2] Source: Joint Committee on Taxation, September 30, 1985, JCX-24-85.

Footnotes

[1] Under current law, 90% of MRB proceeds must be used by first-time homebuyers while all homes purchased with MRB financing must cost no more than 110% of the average area purchase price (120% in targeted areas). Under the Rostenkowski proposal, 100% of MRB proceeds must be used by first-time homebuyers, all homes purchased with MRB financing must cost no more than 90% of the average area purchase price (110% in targeted areas), at least 50% of MRB proceeds must go to borrowers whose family income does not exceed 90% of the area median income while all proceeds must go to families with incomes less than 115% of median income, in targeted areas up to 1/3 of MRB proceeds may go to families with incomes below 140% of either the targeted area median income or the state median income, whichever is more, and Mortgage Credit Certificates (MCCs) would be subject to the same targeting requirements as MRBs.

[2] Current law annual state volume restrictions for MRBs only are the greater of (1) 9 percent of the average annual aggregate principal amount of mortgages executed during the preceding 3 years for single-family owner-occupied residences in the state, or (2) $200 million. Under the Rostenkowski proposal MRBs, IDBs and student loan bonds would fall under a single volume limit of $150 per resident of the state, falling to $100 per resident after 1987 to reflect the present-law sunsetting of tax-exempt MRB authority.

[3] The potential change in home values due to the Reagan and Rostenkowski proposals are computed as follows:

(a) First year mortgage interest equals the home value (V) times the loan-to-value ratio (LV) times the mortgage interest rate (r). In all calculations $LV = .80$ and $r = .13$.

(b) Property taxes are equal to V times the property tax rate (p) which is equal to .0143.

(c) Total before-tax cost (BTC) of mortgage interest and property taxes equals:

$$BTC = V(LV)(r) + V(p) = V(LV*r + p)$$

(d) Homeownership tax savings (TS) is approximated by the marginal tax rate (t) times all deductible homeownership expenses less the amount by which the ZBA exceeds non-homeownership itemized deductions or the excess ZBA (EZBA). If the non-housing itemized deductions are equal to or greater than the ZBA then $EZBA = 0$. Under current law,

$$TS = t(BTC - EZBA).$$

Under the Reagan proposal, where property tax deductibility is specifically repealed,

$$TS = t[V(LV)(r) - EZBA].$$

Footnotes (cont'd)

Under the Rostenkowski proposal, where some property tax deductibility may occur depending upon the typical homeowner's circumstances,

$$TS = t[V(LV)(r) + AP - EZBA],$$

where AP equals allowed property tax deductions. Note that TS closely approximates but does not exactly equal actual tax savings due to the progressive marginal tax rate structure. Actual tax savings may be somewhat less since the last dollar of homeownership deductions is likely to be evaluated at a higher marginal tax rate than the first dollar of such deductions.

(e) After-tax cost (ATC) equals:

$$ATC = BTC - TS.$$

(f) To compute the potential change in home value it is assumed that ATC remains constant across all tax regimes. Therefore, after computing ATC under current law, ATC is held constant, new values are used for t and then the expression is solved for V. Under the Reagan proposal the expression for V is,

$$V = \frac{ATC - t*EZBA}{(LV*r + p) - t(LV*r)}$$

Under the Rostenkowski proposal the expression for V is,

$$V = \frac{ATC + t*AP - t*EZBA}{(LV*r + p) - t(LV*r)}$$

[4] SOURCE: Balance Sheet for the U.S. Economy, Board of Governors of the Federal Reserve System, October 1985.

[5] The 1983 Survey of Consumer Finances, sponsored by the Federal Reserve Board, indicated that the average value of vacation homes was $58,600 in 1983. Interestingly, 60 percent of all vacation homes were owned by households with annual incomes of $30,000 or less while over three fourths of vacation homes were owned by households with incomes of $50,000 or less.

Households Owning Seasonal Residences by Income: 1983[1]

Income Class ($ thousands)	Households Owning Seasonal Residence (# thousands)	Percent of Total Households	Percent of Seasonal Residences	Average Value of Seasonal Residences
0 to 10	581	1.7	26.6	$14,800
10 to 30	740	1.9	33.9	10,600
30 to 50	351	2.3	16.1	13,700
50 to 100	362	8.7	16.6	43,300
Greater than 100	149	18.9	6.8	94,900
Total	2,183	2.4	100.0	$58,600

[1] The definition of seasonal residence includes mobile homes and time sharing units.

SOURCE: 1983 Survey of Consumer Finances.

Footnotes (cont'd)

[6] Under current law at least 20 percent (15 percent in targeted areas) of the rental housing units financed with IDBs must be occupied by persons whose income does not exceed 80 percent of the area median income when they first rent the unit. Under the Rostenkowski proposal, at least 30 percent (25 percent in targeted areas) of the rental housing units financed with IDBs would have to be occupied by persons whose income does not exceed 70 percent of the area median income, with at least 10 percent of all units being occupied by persons whose income does not exceed 50 percent of the area median income, determined on a continuing basis.

[7] Under current law, annual state volume limits on most non-governmental activity IDBs and student loan bonds are the greater of $150 per resident or $200 million. No volume limits are imposed on multifamily rental housing IDBs. Under the Rostenkowski proposal, all non-governmental activity IDBs, including those used to finance multi-family rental housing, student loan bonds, and mortgage revenue bonds would fall under a single volume limit of $150 per resident, declining to $100 per resident after 1987 to reflect the present law sunset of tax-exemption for MRBs. Unless overridden by a state statute, at least 50 percent of each state's volume would have to be used for multi-family rental housing, MRBs, or qualified veterans mortgage bonds. After 1987 that percentage would fall to 25 percent.

Impact of Tax Revision on an $85,000 Owner-Occupied Home[1]

	Current Law	Reagan Proposal	Change from Current Law $	Change from Current Law %	Rostenkowski Proposal	Change from Current Law $	Change from Current Law %
Before-Tax Cost	$10,056	$10,056	--	--	$10,056		
Mortgage Interest	8,840	8,840	--	--	8,840		
Property Tax	1,216	1,216	--	--	1,216		
Marginal Tax Rate	25%	15%	--	-40%	15%	--	-40%
Tax Savings[2]	2,298	1,057	-1,241	-54%	773	-1,525	-66%
Mortgage Interest	2,020	1,057	-963	-48%	773	-1,247	-62%
Property Tax	278	--	-278	-100%	--	-278	-100%
After-Tax Cost	7,758	8,999	+1,241	16%	9,283	+1,525	20%
Home Value	85,000	72,926	-12,074	-14%	70,158	-14,842	-17%

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[1] Example assumes a 20 percent downpayment, a 30-year, fixed-rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Family income assumes that 25 percent of gross income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions. Current tax law calculations are based on values for personal exemptions, standard deduction or zero bracket amount, and tax brackets projected for 1986.

[2] Tax savings is computed as the difference in tax liability between a homeowner and renter with the same AGI, the same number of exemptions, and the same amount of non-housing itemized deductions. Tax savings decline under the Reagan and Rostenkowski proposals due to lower marginal tax rates, effective elimination of property tax deductibility under both proposals, and increases in the zero bracket amount or standard deduction. Since the ZBA or standard deduction under both the Reagan and Rostenkowski proposals exceed the amount of non-housing deductions, itemized deductions in excess of the ZBA or standard deduction are less than the amount of mortgage interest. As a result tax savings is less than 15 percent of mortgage interest.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Appendix B

Impact of Tax Revision on an $50,000 Owner-Occupied Home[1]

	Current Law	Reagan Proposal	Change from Current Law		Rostenkowski Proposal	Change from Current Law	
			$	%		$	%
Before-Tax Cost	$5,915	$5,915	--	--	$5,915		
Mortgage Interest	5,200	5,200	--	--	5,200		
Property Tax	715	715	--	--	715		
Marginal Tax Rate	16%	15%	--	-6%	15%	--	-6%
Tax Savings[2]	868	470	-398	-46%	189	-679	-78%
Mortgage Interest	763	470	-293	-38%	179	-584	-77%
Property Tax	105	--	-105	-100%	10	-95	-90%
After-Tax Cost	5,047	5,445	+398	8%	5,726	+679	13%
Home Value	50,000	46,126	-3,874	-8%	43,389	-6,611	-13%

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[1] Example assumes a 20 percent downpayment, a 30-year, fixed-rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Family income assumes that 25 percent of gross income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions. Current tax law calculations are based on values for personal exemptions, standard deduction or zero bracket amount, and tax brackets projected for 1986.

[2] Tax savings is computed as the difference in tax liability between a homeowner and renter with the same AGI, the same number of exemptions, and the same amount of non-housing itemized deductions. Tax savings decline under the Reagan and Rostenkowski proposals due to lower marginal tax rates, effective elimination of property tax deductibility under both proposals, and increases in the zero bracket amount or standard deduction. Since the ZBA or standard deduction under both the Reagan and Rostenkowski proposals exceed the amount of non-housing deductions, itemized deductions in excess of the ZBA or standard deduction are less than the amount of mortgage interest. As a result tax savings is less than 15 percent of mortgage interest.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Appendix C

Impact of Tax Revision on an $150,000 Owner-Occupied Home[1/]

	Current Law	Reagan Proposal	Change from Current Law		Rostenkowski Proposal	Change from Current Law	
			$	%		$	%
Before-Tax Cost	$17,745	$17,745	--	--	$17,745		
Mortgage Interest	15,600	15,600	--	--	15,600		
Property Tax	2,145	2,145	--	--	2,145		
Marginal Tax Rate	38%	25%	--	-34%	25%	--	-34%
Tax Savings[2/]	5,908	3,900	-2,008	-34%	3,588	-2,320	-39%
Mortgage Interest	5,194	3,900	-1,294	-25%	3,462	-1,732	-33%
Property Tax	714	--	-714	-100%	126	-588	-82%
After-Tax Cost	11,837	13,845	+2,008	17%	14,157	+2,320	20%
Home Value	150,000	128,245	-21,755	-15%	124,865	-25,135	-17%

[1/] Example assumes a 20 percent downpayment, a 30-year, fixed-rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Family income assumes that 25 percent of gross income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions. Current tax law calculations are based on values for personal exemptions, standard deduction or zero bracket amount, and tax brackets projected for 1986.

[2/] Tax savings is computed as the difference in tax liability between a homeowner and renter with the same AGI, the same number of exemptions, and the same amount of non-housing itemized deductions. Tax savings decline under the Reagan and Rostenkowski proposals due to lower marginal tax rates, effective elimination of property tax deductibility under both proposals, and increases in the zero bracket amount or standard deduction. Since the ZBA or standard deduction under both the Reagan and Rostenkowski proposals exceed the amount of non-housing deductions, itemized deductions in excess of the ZBA or standard deduction are less than the amount of mortgage interest. As a result tax savings is less than 15 percent of mortgage interest.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Total Impact of Reagan Proposal on After-Tax Homeownership Costs and Home Value by State

State	Average Home Price (Dollars)	Average Property Tax Rate (Percent)	Average Increase in After-Tax Homeownership Cost (Percent-Dollars)		Average Decline In Home Value (Percent-Dollars)	
Alabama	$56,500	0.42%	5%	$260	-5%	$-2,800
Alaska	136,700	1.06	11	1,180	-9	-12,000
Arizona	85,000	0.71	12	890	-11	-9,400
Arkansas	57,800	1.29	7	400	-7	-4,000
California	121,700	1.05	8	830	-8	-9,400
Colorado	90,700	0.95	14	1,100	-13	-11,300
Connecticut	118,800	1.60	13	1,270	-11	-13,500
Delaware	79,600	0.76	14	990	-13	-10,300
District of Columbia	133,600	1.17	11	1,150	-10	-12,800
Florida	76,100	0.92	12	790	-11	-8,100
Georgia	83,700	1.16	12	930	-11	-9,300
Hawaii	158,300	0.60	18	1,980	-15	-23,600
Idaho	58,100	1.02	8	440	-8	-4,500
Illinois	95,800	1.72	14	1,240	-12	-11,800
Indiana	70,800	1.23	12	770	-11	-7,600
Iowa	68,800	1.67	11	740	-10	-7,000
Kansas	68,800	1.00	10	620	-9	-6,300
Kentucky	66,100	1.02	10	600	-9	-6,000
Louisiana	72,500	0.14	10	620	-10	-6,900
Maine	67,000	1.52	11	740	-11	-7,200
Maryland	94,200	1.38	13	1,120	-12	-11,000
Massachusetts	101,300	1.85	10	960	-9	-9,000
Michigan	79,900	2.68	16	1,300	-14	-11,200
Minnesota	81,300	0.85	15	1,100	-14	-11,000
Mississippi	61,400	0.82	6	350	-6	-3,700
Missouri	64,100	1.09	8	500	-8	-5,100
Montana	46,600	1.17	8	350	-8	-3,500
Nebraska	62,700	2.12	9	600	-9	-5,500
Nevada	93,800	0.68	13	970	-11	-10,200
New Hampshire	87,100	2.23	17	1,470	-15	-13,300
New Jersey	110,000	2.54	12	1,270	-10	-11,200
New Mexico	60,500	0.90	4	230	4	-2,300
New York	95,300	2.66	13	1,260	-12	-10,900
North Carolina	65,800	0.96	9	550	-9	-5,600
North Dakota	70,800	1.26	8	560	-8	-5,500
Ohio	84,800	1.15	16	1,230	15	-12,300
Oklahoma	73,800	0.89	11	750	-11	-7,700
Oregon	68,700	2.27	12	840	-11	-7,500
Pennsylvania	58,100	1.71	9	540	-9	-5,100
Rhode Island	86,600	2.01	18	1,460	-16	-13,500
South Carolina	78,100	0.85	12	830	11	-8,600
South Dakota	56,200	1.75	9	540	8	-4,600
Tennessee	71,900	1.17	18	1,460	-6	-4,600
Texas	85,300	1.36	12	830	12	10,500
Utah	85,800	0.97	9	480	-9	-8,000
Vermont	65,500	1.67	7	460	10	-6,200
Virginia	91,900	1.28	14	1,070	-13	-11,900
Washington	80,900	1.03	10	790	-13	-10,700
West Virginia	54,400	0.68	8	410	-8	-4,300
Wisconsin	87,600	1.90	18	1,450	-15	13,500
Wyoming	60,500	0.45	6	330	-6	-3,500

SOURCE: NATIONAL ASSOCIATION OF REALTORS

Impact of Tax Revision on Federal Tax Burden of Homeowner[1]

	Current Law		Administration Proposal		Rostenkowski Proposal	
	Homeowner	Renter	Homeowner	Renter	Homeowner	Renter
Income	$36,000	--	$36,000	$36,000	$36,000	$36,000
Employer paid health premiums	--	--	300	300	--	--
Second earner exclusion	-594	--	--	--	--	--
Miscellaneous deductions	--	--	-105	-105	--	--
Adjusted Gross Income	35,406	--	36,195	36,195	36,000	36,000
Exemptions	-4,320	--	-8,000	-8,000	-6,000	-6,000
Itemized Deductions						
Mortgage interest	-8,840	--	-8,840	--	-8,840	--
Real Property taxes	-1,216	--	--	--		--
Other taxes:	--					
S&L Income Taxes	-1,296	--	--	--	-1,000	-1,000
S&L Sales Taxes	-504	--	--	--	--	--
Personal Property Taxes	-36	--	--	--	--	--
Other	-36	--	--	--	--	--
Other interest	-1,080	--	-1,080	-1,080	-1,080	-1,080
Miscellaneous Deductions	-468	--	--	--	-105	-105
All other	-1,130	--	-1,130	-1,130	-1,030	-1,130
Subtotal	-14,606	--	-11,050	-2,210	-12,155	-3,315
Less: ZBA	3,670	--	4,000	4,000	--	--
Total Itemized Deductions	-10,936	--	-7,050	0	-12,155	--
Standard Deduction	--	--	--	--		-7,000
Taxable Income	20,150	--	21,145	28,195	17,845	23,000
Tax Liability before credits	2,398	--	2,572	3,629	2,677	3,450
Child care credit	-285	--	-285	-285	-285	-285
Tax liability	$ 2,113	--	$ 2,287	$3,344	$ 2,392	$3,165

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[1] Table assumes a joint return with four exemptions. Household consists of two earners with shares of total income split two-thirds, one-third. Mortgage interest based on an $85,000 home financed with a 20 percent downpayment and an 80 percent, 30-year, fixed-rate mortgage loan at 13 percent. Property taxes are 1.43 percent of home value. Values for all other itemized deductions and the child care credit are averages for taxpayers at the $36,000 income level as reported in the 1983 Statistics of Income—Individual Tax Returns.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Depreciation Allowances for Structures Per $1,000 of Investment 1/

Years	Current Law (19 years) Cummulative Present Value ACRS2/	Current Law (19 years) Cummulative Present Value St. Line	CCRS (Reagan) Cummulative Present Value	CCRS (Reagan) % Diff. from Current Law ACRS2/	CCRS (Reagan) % Diff. from Current Law St. Line	Rostenkowski Cummulative Present Value	Rostenkowski % Diff. from Current Law ACRS2/	Rostenkowski % Diff. from Current Law St. Line
1	$ 46	$ 26	$ 20	-56.5%	-23.1%	$ 17	-63.0%	-34.6%
2	124	73	56	-54.8	-23.3	46	-62.9	-37.0
3	187	114	89	-52.4	-21.9	72	-61.5	-36.8
4	236	150	118	-50.0	-21.3	95	-59.7	-36.7
5	277	183	144	-48.0	-21.3	116	-58.1	-36.6
6	309	211	169	-45.3	-19.9	134	-56.6	-36.5
7	335	237	192	-42.7	-19.0	150	-55.2	-36.7
8	356	259	213	-40.2	-17.8	164	-53.9	-36.7
9	373	279	232	-37.8	-16.8	176	-52.8	-36.9
10	387	296	251	-35.1	-15.2	188	-51.4	-36.5
11	399	312	268	-32.8	-14.1	197	-50.6	-36.9
12	410	325	283	-31.0	-12.9	206	-49.8	-36.6
13	420	338	298	-29.0	-11.8	214	-49.0	-36.7
14	428	348	312	-27.1	-10.3	221	-48.4	-36.5
15	436	358	324	-25.7	-9.5	227	-47.9	-36.6
16	443	366	336	-24.2	-8.2	232	-47.6	-36.6
17	449	374	347	-22.7	-7.2	237	-47.2	-36.6
18	454	380	357	-21.4	-6.1	241	-46.9	-36.6
19	459	386	367	-20.0	-4.9	244	-46.8	-36.8
20	461	389	375	-18.7	-3.6	248	-46.2	-36.2
21	na	na	384	na	na	251	na	na
22	na	na	391	na	na	253	na	na
23	na	na	398	na	na	255	na	na
24	na	na	405	na	na	257	na	na
25	na	na	411	na	na	259	na	na

Depreciation Allowances for Structures Per $1,000 Investment 1/

	Current Law (19 years)		CCRS (Reagan)			Rostenkowski		
	Cummulative Present Value			% Diff. from Current Law			% Diff. from Current Law	
Years	ACRS 2/	St. Line	Cummulative Present Value	ACRS 2/	St. Line	Cummulative Present Value	ACRS 2/	St. Line
26	na	na	$416	na	na	$261	na	na
27	na	na	422	na	na	262	na	na
28	na	na	427	na	na	263	na	na
29	na	na	429	na	na	264	na	na
30	na	na	na	na	na	265	na	na
31	na	na	na	na	na	266	na	na

1/ First year allowance assumes an asset is placed in service by a calendar year taxpayer on July 1, without regard to the mid-month convention. Cummulative present value calculation assumes a real interest rate of 8 percent and an inflation rate of 5 percent.

2/ ACRS is 175 percent declining balance with optimal switching to straight line.

na-Not applicable.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

By DR. JACK CARLSON
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DECEMBER 1985

Outlook for the Economy and Real Estate

The revised annual growth rate for third quarter real Gross National Product of 4.3 percent reflects a transitory boost from end of the fiscal year federal spending and discount auto financing. This real growth rate is unlikely to continue in the present quarter given the huge level of consumer debt and the record low personal savings rate. In October, retail sales dropped off 3.3 percent and aggregate personal outlays declined 0.9 percent mostly due to reduced auto sales, but also because consumers are reining in their spending to reduce debt burdens and replenish savings. With growth of consumption spending slowing, renewed economic growth depends heavily on business investment. Inventory investment will rise as a consequence of the recent flurry in durable goods spending, but these advances should be offset by the expected slow pace of residential and non residential fixed investment. Accordingly, GNP growth should remain at about 2.0 percent in the fourth quarter of 1985 and at or below that level through 1986.

The unemployment rate for October remained at 7.1 percent despite the creation of 323,000 new jobs. This indicates the economy is not expanding fast enough to absorb new entrants to the job market. With lackluster GNP growth expected, the unemployment rate could slowly rise through 1986, ending 1986 at about 7.5 percent. A rebounding economy in 1987 could generate enough jobs to reduce the unemployment rate modestly.

Consumer price inflation should remain moderate through 1985 and 1986 because weakening capacity and additional people looking for work prevent either demand pull or supply push inflation. Consumer prices in 1986 should track below 1985 at 3.2 percent in part because of slower overall economic growth. Stronger GNP growth in 1987 should be accompanied by a slightly higher inflation rate of about 3.6 percent. For all of 1985, producer prices are expected to decrease 0.6 percent before accelerating modestly in 1986 and 1987.

Slower GNP growth in 1986 will reduce the overall investment demand and allow long term interest rates to trend downward during 1986. Continuation of low levels of inflation will reduce inflationary expectations in the future. The recent Congressional delay in raising the national debt ceiling prevented the Treasury from raising the necessary operational funds for the government in the credit markets. As a result, unusually large government auctions should cause short term interest rates to rise in the present quarter and into the first quarter of 1986, but should then trend downward through 1986.

Real Estate Markets

With mortgage interest rates declining and affordability improving, the outlook for the real estate sector is positive. Sales of existing single family homes rose to an annual rate of 3.49 million units in October, a 27.4 percent increase over October 1984. This marked the eighth month in 1985 that resale activity exceeded 3.0 million units, a performance not equalled since the 1976 1980 period. With the continuing drop in mortgage interest rates, sales of existing single family homes should rise to over 3.3 million units in 1986 and about 3.4 million units in 1987. Due to the strong demand for new and existing homes, builders are gaining confidence in constructing more homes. This was the likely impetus for strong growth in October housing starts activity that registered a 10.8 percent gain over September to achieve an annual rate of 1.76 million units. Housing starts should continue at about 1.76 million units through 1985 before strengthening to 1.84 million units in 1986 and 1.87 million units in 1987. Unfortunately, first time howmeowners comprise a smaller proportion of sales than in the 1970's reflecting the greater difficulty of saving the downpayment and affording the monthly payments. This is a primary cause of the five year downturn in the homeownership rate, from 66% in 1980 to 64% in 1985.

Commercial Real Estate

While a favorable downward trend in long term interest rates is welcome news to the nonresidential building sector, the prospects of a continued sluggish economy, federal budget cutbacks, and the uncertainty of tax reform make for a mixed outlook in this sector. Total nonresidential construction should peak at just under 1.3 billion square feet for 1985, and fall to about 1.2 billion square feet in 1986. Construction of office buildings, though currently on a near record-breaking pace of 310 million square feet, will drop off considerably to 250 million square feet in 1986 as builders adjust to the anticipated effects of a tax reform package and a vacancy rate that has tripled since 1981.

Stores and other commercial construction, which traditionally responds to housing construction, can be expected to end 1985 at the rate of 548 million square feet. Retail building, accounting for 425-475 million square feet of this total, should maintain this rate through 1986 as long as lower mortgage interest rates continue to spur housing demand. Allowing for slow economic growth and the possibility of tax reform, building in this sector should drop to 507 million square feet in 1986 with retail construction accounting for 450 million square feet.

Industrial building construction has suffered from the major problems facing the manufacturing sector. The over-valued U.S. dollar, brought on by federal deficit spending, has led to high real interest rates and resulted in record-breaking trade deficits that have dragged manufacturing operating rates slowly downward. Even a measured, steady fall in the value of the U.S. dollar will take a few years to translate into major improvement in the U.S. trade balance. Industrial construction should continue at about 140 to 145 million square feet through 1986.

Commercial and Industrial Building Contracts

	Stores and Other Commercial		Office Buildings		Industrial Buildings	
Year	millions of sq ft	percent change	millions of sq ft	percent change	millions of sq ft	percent change
1981	337	-11%	325	+15%	187	-13%
1982	245	-27%	261	-20%	118	-37%
1983	362	+48%	281	+ 8%	107	-37%
1984	478	+32%	318	+13%	144	+33%
1985^p	548	15%	310	- 3%	140	- 3%
1986^f	507	-7%	250	-19%	145	+ 4%

p: preliminary
f: forecast

Source: Historical Data: DRI, Review of the U.S. Economy, November 1985.
Forecasts: NATIONAL ASSOCIATION OF REALTORS®

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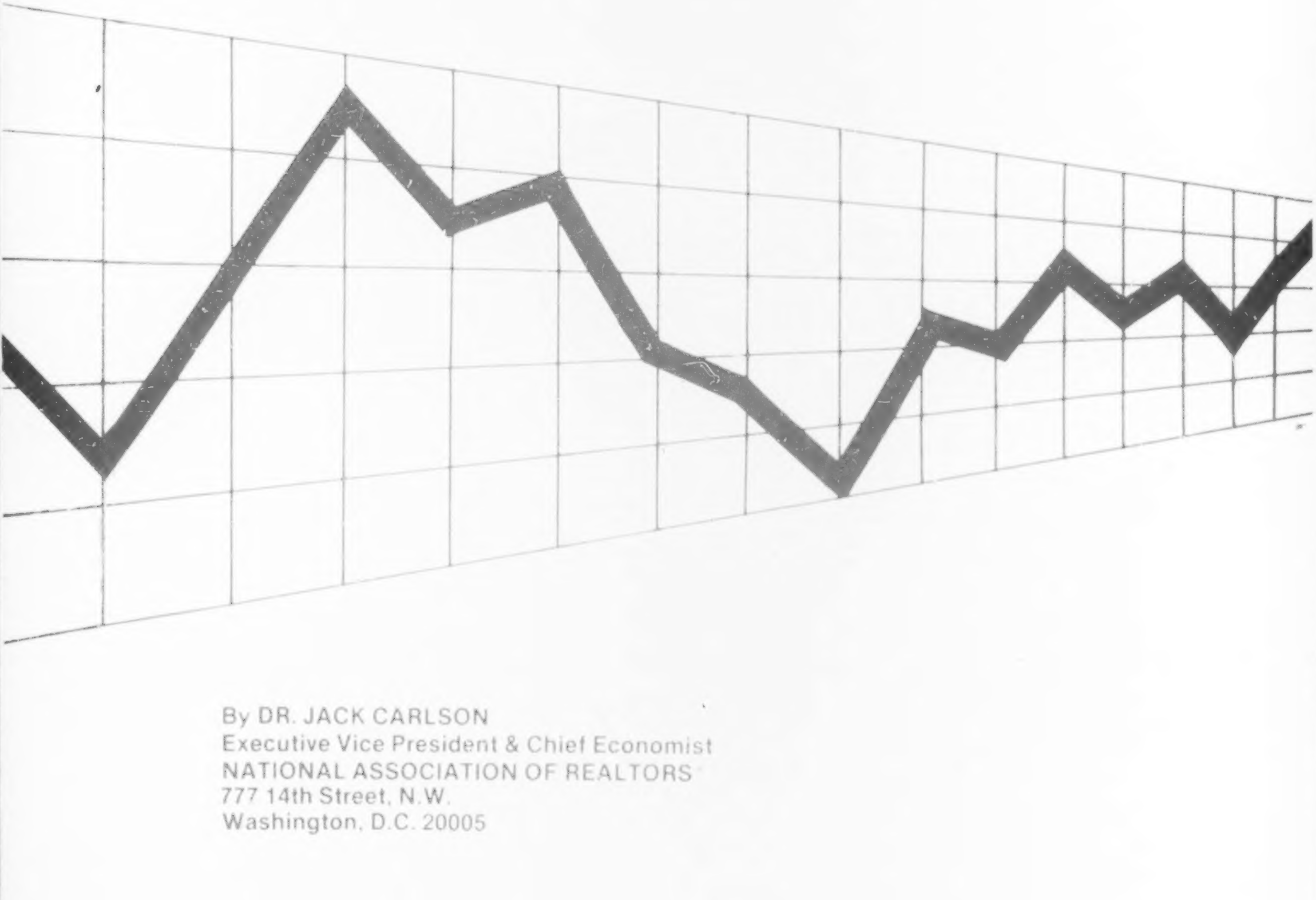
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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JANUARY 1986

The Outlook for the Economy and Real Estate

The flash estimate of a 3.2 percent growth rate for fourth quarter Gross National Product (GNP) was due mostly to inventory re-stocking activity by manufacturers, as moderate growth in real final sales signaled the onset of the expected decline in personal consumption expenditures. The government also revised the third quarter growth rate for GNP from 4.3 percent to 3.0 percent indicating considerably slower growth because of falling inventory investment. The fourth quarter flash estimate for GNP is expected to be revised down given the recent slowing in consumer spending coupled with the recent slip in housing starts. GNP growth could slow further to 1.0 percent in the first quarter of 1986 as manufacturers reduce production because of high inventory levels that can not be depleted by financially-strapped consumers. The presently high levels of consumer debt will be pushed even higher during the holiday buying season and should restrict consumer outlays in the new year as consumers attempt to boost personal savings to pay off their debts. Growth in output should rise modestly during the remainder of 1986 averaging 2.0 percent for the year.

The unemployment rate declined slightly in November to 7.0 percent, down from 7.1 percent in October. Civilian employment rose by 60,000 new jobs to almost 108 million in November, but this increase was offset by 92,000 workers who left the workforce. The expected sluggish GNP growth could raise unemployment in 1986 before stabillizing in 1987 as economic growth is renewed.

Prices for food and energy products forced the consumer price index 0.6 percent higher in November and about 3.6 percent above 12 months ago. The November increases in the capacity utilization rate and the industrial production index were due to high levels of consumer spending and inventory investment, and do not mean the return of rapid economic growth and rekindled inflation. Consumer price inflation should fall slightly in 1986 before rising in 1987.

The recent passage of the Gramm-Rudman-Hollings legislation to eliminate deficits by 1991 is a symbol of Congressional concern for high federal deficits. However, after implementation this measure will prove but a modest step towards reducing deficits and artificially high real interest rates that have restrained real economic growth. Slow economic growth should allow long-term interest rates to fall modestly in the first half of 1986, before stabillizing as economic growth returns in 1987. Short-term interest rates should continue on a modest downward trend through 1986, and could drop significantly lower if the Federal Reserve acts quickly to smooth the transition from fiscal to monetary stimulation of the economy that is implied by passage and modest implementation of Gramm-Rudman-Hollings.

Real Estate Markets

The severe winter storms in the Northeast and Midwest are largely responsible for the 12.2 percent drop in November housing starts activity. Housing starts have been erractic since the spring, so a one month decline is not significant. Housing starts should total 1.73 million in 1985 and lower interest rates should raise starts to almost 1.85 million in 1986. Existing single-family home sales, which have recorded healthy gains since August, are expected to average 3.35 million units in 1986, and 3.4 million units in 1987. The median price of an existing single-family home in November retreated to $74,600, from a revised October median price of $74,800. Responding to this housing activity, stores and other commercial construction should total 507 million square feet in 1986. Office building construction should retreat from the near record- breaking pace of 310 million square feet in 1985 to about 250 million square feet in 1986. Industrial building construction should total about 145 million square feet in 1986 as the depreciating U.S. dollar strengthens foreign markets for U.S. goods.

Special Supplement

Economic Impacts of The Gramm-Rudman-Hollings Deficit Reduction Legislation

On December 11, Congress passed and the President signed the Balanced Budget and Emergency Deficit Control Act of 1985, otherwise known as the Gramm-Rudman-Hollings (GRH) proposal. This legislation, sponsored by Senators Gramm (R., Texas), Rudman (R., New Hampshire) and Hollings (D., South Carolina), establishes a path of shrinking deficits starting in FY1986. The mandated deficit targets are as follows: $172 billion in FY1986, $144 billion in FY1987, $108 billion in FY1988, $72 billion in FY1989, $36 billion in FY1990, and a balanced budget in 1991. The Administration is constrained by these deficit limits in formulating the annual budget that is submitted to the Congress. Similarly, Congressional budget resolutions are required to adhere to these targets.

On March 1, 1986 and then on each following September 1, the Congressional Budget Office (CBO) and the Administration's Office of Management and Budget (OMB) are required to prepare estimates of the deficit for the remainder of FY1986 or the following fiscal year, taking into account expected economic conditions and Congressional budget actions as of that date. These estimates are to be submitted to the Comptroller General of the General Accounting Office (GAO) who is to review the estimates and resolve differences. If GAO determines that the projected deficit exceeds the target for the fiscal year by more than $10 billion, the President would be required to make automatic spending reductions to achieve that target if Congress and the President are unable to agree on an alternative plan by October 15. Defense would take half of the automatic spending cuts while domestic programs would take the other half, with Social Security, interest on the debt, and the primary low-income programs exempt. Note that while the automatic feature of the bill calls for spending reductions only, taxes could be increased as part of an alternative plan to achieve the deficit target.

Also included in the bill is a provision for waiving this procedure in the event of a weak economy. If CBO or OMB project two consecutive quarters of negative growth in real or inflation-adjusted Gross National Product (GNP) or if the Department of Commerce reports that real GNP growth during the current quarter and the immediately preceeding quarter is less than 1 percent, the deficit target is waived for the remainder of the current fiscal year and/or the following fiscal year.

Provided the Federal Reserve Board (FED) acts quickly to offset the decline in aggregate demand resulting from the cuts in federal spending with lower interest rates brought on by a more accommodative monetary policy, deficit reduction through spending cuts would have very desirable impacts on overall economic performance. As shown in Table 1, long-term interest rates would likely decline by 2 percentage points within five years. Lower interest rates would have numerous beneficial impacts--increased activity in the interest-sensitive sectors of the economy such as housing and business investment, a reduced value of the dollar which would allow a steady decline in the U.S. trade deficit, and further reductions of the federal deficit by reducing interest payments on the outstanding federal debt. Within five years total employment would increase by over a million jobs. The only negative effect would be an increase of inflation of about one percentage point. This would be due primarily to the reduced value of the dollar which would boost the cost of imported goods and services and diminish price pressure on domestic producers. However, this increase in inflation would subside as the dollar stabilized at its new lower value. Without an accommodative shift in monetary policy, the reduction in federal spending prescribed by GRH would cause weakness in the economy. However, that fact plus continued low inflation should pressure the FED into providing the needed stimulus.

Table 1

Macroeconomic Impacts of the Gramm-Rudman-Hollings Proposal with Accommodative Monetary Policy
(percent change from baseline)

	1986	1987	1988	1989	1990	1991
Real GNP	0.1	0.6	1.2	1.8	2.1	2.3
Inflation (Percentage Points)	-0.3	0.4	0.5	0.7	0.9	1.0
Employment (Millions of Jobs)	0.0	0.2	0.4	0.7	1.0	1.3
Mortgage Rate (Percentage Points)	-0.7	-1.3	-1.6	-1.8	-2.0	-2.0
Housing Starts (Thousand of Units)	100	225	280	310	320	330
Nonresidential Investment						
Equipment	0.5	2.7	6.2	10.1	13.1	13.5
Structures	0.3	2.1	4.9	8.8	12.8	15.8

Source: NATIONAL ASSOCIATION OF REALTORS®

Unfortunately, these desirable impacts of deficit reduction are unlikely to come about due to the inability to reach a political consensus on the required cuts in spending. The President will likely resist deep cuts in defense spending while House Democrats will likely resist deep cuts in social programs. This leaves two options-either tax increases or GRH will be subverted or repealed through future legislation. At this point it seems reasonable to expect that some deficit reduction will occur in roughly the following proportions-1/3 from defense, 1/3 from social programs, and 1/3 from increased taxes. The tax increases are unlikely to come from across-the-board increases in personal and corporate tax rates. Rather, revenues are likely to be raised through a stiffer individual and corporate minimum tax and through further dilution of investment incentives, such as reduction or repeal of the investment tax credit and lengthening of cost recovery periods for depreciable assets. Unfortunately, such tax increases would to a large extent nullify the positive impacts of lower interest rates on business investment. As a result the economic benefits of deficit reduction with these types of tax increases are significantly less than deficit reduction achieved solely through spending cuts.

Further, even if GRH is not repealed or weakened through future legislation, there are sufficient escape clauses within the bill that the prescribed deficit targets are unlikely to be achieved. Thus, the deficit in FY1987 is more likely to decline to about $175 billion, not $144 billion. While GRH is likely to produce some deficit reduction, it would be a mistake to assume that its passage has put us on a path toward a balanced budget by 1991.

U.S. ECONOMIC OUTLOOK

[illegible]

	QUARTERS								YEARS				
	[illegible]	[illegible]							Actual		Forecast		
	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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Commercial Paper Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Prime Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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February 1986

Outlook for the Economy and Real Estate

REALTOR®

Forecasting & Policy
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Outlook for the Economy and Real Estate

The growth rate for real (inflation-adjusted) Gross National Product (GNP) in the fourth quarter of 1985 has been revised downward to 2.4 percent, down sharply from the "flash" estimate of 3.2 percent and the 3.0 percent growth rate of the third quarter. The downward revision was due primarily to a larger than previously expected trade deficit. The primary cause of the slower fourth quarter growth rate was an actual decline in consumer spending for durable goods such as automobiles as consumers restrained spending due to high debt burdens. For the entire year, real GNP increased 2.3 percent compared to the 6.6 percent growth rate of 1984.

Despite the slowdown for the entire quarter, in December there were some signs of a renewal of economic growth. Payroll employment rose 320,000 during that month, well above the 180,000 increase of November, and the civilian unemployment rate fell to 6.9 percent. Retail sales rose 1.9 percent for the month while industrial production rose 0.7 percent. These indicators of faster economic growth brought the bond rally to a halt as they were interpreted to preclude further easing of monetary policy by the Federal Reserve Board (FED) at this time.

This modest rebound of the economy is expected to continue through the first quarter of 1986, with real GNP growth rising to 2.6 percent. This expected pickup in growth is due primarily to improved automobile and light truck sales, as manufacturers again provide financing incentives, and inventory rebuilding. By the second quarter of 1986 growth should decline to about 2.0 percent as both consumer spending and inventory investment subside. By the second half of 1986 and well into 1987 real economic growth should remain at or below 2.0 percent with a recession becoming a stronger possibility. Deficit reduction mandated under Gramm-Rudman-Hollings could exacerbate this slowing of economic growth unless the FED stimulates the economy through a further easing of monetary policy.

For all of 1985 inflation, as measured by the Consumer Price Index (CPI), was 3.8 percent compared to 4.0 percent in 1984. Despite some indications that inflation may accelerate, such as the decline in the dollar and higher average wage increases, during 1986 these forces are likely to be offset by declining oil prices. In fact, for all of 1986 inflation should further slow to 3.2 percent. However, inflation is likely to start accelerating in 1987.

Modest inflation, weak economic growth, and hope that advances are finally being made in deficit reduction have reduced long-term interest rates by one and one-half percentage points over the past three months, while short-term rates have remained fairly constant. Declines in long-term rates will likely resume once credit markets and the Federal Reserve gain confidence that the current economic rebound is both modest and short-lived. Further, pressure on the FED from the Administration and Congress add to the likelihood of further easing of monetary policy.

Real Estate Markets

Strong response to falling mortgage interest rates raised existing single-family home sales to 3.53 million units in December from a rate of 3.42 million units in November. For the first time since 1979, the 1985 sales total in the resale market broke the three million unit mark at 3.216 million homes sold. With further modest declines in mortgage rates of one-quarter to one-half percentage points in 1986 home resales should total 3.5 million units in 1986 and 3.4 million units in 1987. The December median resale price increased $200 to return to its October level of $74,800. During 1985 the median resale price rose 3.7 percent. Housing starts surged 17.5 percent in December to an annual rate of 1.84 million units bringing the 1985 year-end total to 1.73 million units. Starts should decrease in 1986 to 1.78 million units and 1.75 million units as economic activity slows in 1987.

TABLE I

February 1986

U.S. Economic Outlook

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4016.9	4075.1	4137.6	4187.9	4229.2	4277.2	4326.8	4376.5	3774.7	3992.5	4208	4393	4517.6
% Change	5.8	5.9	6.3	5.0	4.0	4.6	4.7	4.1	11.0	5.8	5.4	4.4	5.1
% Change (w/out inflation)	3.0	2.4	2.6	2.1	1.5	2.1	1.7	1.0	6.6	2.3	2.2	1.5	1.1
Consumption	4.6	-0.2	2.7	2.2	1.5	1.4	1.8	0.7	4.4	3.2	2.1	1.2	0.6
Durables	24.3	-15.7	5.0	2.2	-0.3	0.8	2.6	-1.2	12.4	8.2	1.5	0.5	0.0
Nondurables	1.5	1.5	2.4	2.2	1.9	1.5	1.6	1.0	3.4	2.3	2.0	1.3	0.7
Services	1.4	3.9	2.4	2.2	1.9	1.5	1.6	1.0	3.0	2.5	2.3	1.3	0.7
Residential Investment	8.5	8.6	5.3	5.3	3.0	1.8	1.1	-0.2	13.2	1.9	5.9	1.1	-2.6
Nonresidential Investment	2.4	10.3	6.0	3.7	5.4	4.0	1.3	-0.6	19.5	9.7	6.1	1.8	0.3
Structures	1.2	6.4	1.0	0.1	-0.4	2.0	1.8	1.6	14.7	11.4	2.0	1.3	0.9
Equipment	3.0	12.4	8.7	5.6	8.5	1.9	1.0	1.6	22.2	8.7	8.3	2.0	0.0
Exports	5.1	8.0	5.6	5.1	4.9	4.9	4.6	4.4	6.2	-2.9	3.3	4.6	3.9
Imports	12.8	13.0	9.7	6.9	1.5	0.7	0.2	-2.3	22.8	2.1	9.0	-0.4	-2.1
Government Purchases	18.2	7.0	6.1	5.1	-0.7	0.6	0.2	0.2	4.3	5.9	1.0	-0.2	1.5
Contribution to GNP Growth													
Consumption	3.0	0.1	1.8	1.4	1.0	0.9	1.1	0.5	2.2	1.9	1.3	0.5	0.4
Residential Investment	0.4	0.4	0.3	0.3	0.1	0.1	0.1	0.0	0.2	0.3	0.2	0.0	-0.2
Nonresidential Investment	0.3	1.3	0.8	0.5	0.7	0.5	0.2	-0.1	1.9	0.8	0.6	0.0	0.1
Structures	0.1	0.3	0.0	0.0	0.0	0.1	0.1	0.1	0.6	0.4	0.0	0.1	0.0
Equipment	0.3	1.0	0.7	0.5	0.7	0.4	0.1	0.2	1.3	0.4	0.6	-0.1	0.1
Inventory Change ($ billions)	1.9	0.2	1.8	1.4	0.5	0.0	0.2	-0.2	0.4	1.0	0.7	-0.2	0.1
Net Exports	2.1	0.9	0.7	-0.4	0.3	0.4	0.5	0.8	1.5	-0.8	0.1	0.8	0.6
Government Purchases	3.4	1.4	1.3	-1.0	0.1	0.1	0.0	0.0	1.5	1.4	-0.6	0.0	0.5
Mfg. Capacity Utilization Rate	80.3	79.9	79.9	79.6	79.0	78.8	78.4	77.9	80.8	80.3	79.3	77.7	76.6
Personal Income Per Household	40,039	40,658	41,163	41,581	41,971	42,385	42,950	43,337	38,527	39,159	41,159	43,180	45,526
% Change	2.3	7.3	6.0	5.1	4.8	5.0	6.4	4.6	9.7	5.9	5.3	5.1	5.7
Personal Taxes Per Household	6,049	6,179	6,183	6,270	6,353	6,[illegible]	6,461	6,544	6,710	5,862	6,219	6,534	6,945
% Change	3.1	2.1	0.1	1.4	1.3	4	0.3	1.3	2.5	12.6	6.1	5.1	6.3
% of Personal Income	15.1	15.2	15.0	15.1	15.1	15.2	15.0	15.1	17.4	15.0	15.1	15.1	15.3
Disposable Personal Income Per Household	33,990	34,480	34,980	35,312	35,618	35,946	36,489	36,793	31,817	33,297	34,941	36,646	38,581
% Change	-2.5	6.9	6.9	4.8	4.5	4.7	7.2	4.3	10.1	4.9	5.2	5.1	5.5
Employment (millions) (civilian household basis)	115.5	116.2	116.6	117.0	117.4	117.7	118.1	118.5	113.5	115.5	117.2	118.6	119.8
% Change	1.1	2.4	1.4	1.4	1.4	1.2	1.3	1.2	1.8	1.7	1.5	1.2	1.0
Unemployment Rate (%) (civilian)	7.2	7.0	7.0	7.0	7.1	7.1	7.1	7.3	7.5	7.2	7	7.3	7.8
Consumer Prices (CPI)	2.3	4.2	2.9	3.2	3.1	3.6	3.9	3.9	4.3	3.5	3.3	3.7	4.6
GNP Deflator	2.9	3.3	3.7	2.8	2.5	2.5	3.0	3.1	4.1	3.3	3.1	2.9	3.9
Personal Cons. Inflation	2.2	4.4	2.9	3.3	3.2	3.6	3.9	4.0	4.1	3.2	3.3	3.8	4.6
Residential Construction Inflation	1.1	3.0	2.3	2.2	2.3	2.7	3.3	3.3	4.2	1.7	2.2	3.0	4.1
Nonresidential Construction Inflation	1.2	0.4	2.3	0.8	1.1	0.9	1.7	1.9	0.5	1.4	1.2	1.5	3.0
Producer Price Inflation	0.7	4.2	2.4	2.9	3.3	4.2	4.5	4.6	2.1	0.9	2.6	4.2	5.0
Before Tax Corporate Profit	228.6	243.0	232.6	230.2	220.6	218.8	203.7	194.7	237.6	227.6	225.5	192.3	157.1
Corporate Tax Liability	87.5	92.9	87.6	86.4	81.5	80.5	73.4	69.3	93.6	86.6	84.0	68.2	51.5
After Tax Profits	141.1	150.1	145.0	143.8	139.1	138.3	130.3	125.4	144.0	141.0	141.5	124.1	105.6
Inventory Valuation Adjustment	4.7	9.0	5.3	-2.7	11.5	18.1	20.2	20.9	-5.4	-0.4	11.1	21.2	-26.3
Capital Consumption Adjustment	75.9	83.2	88.4	94.4	100.2	106.0	111.2	116.2	41.0	71.8	97.2	118.5	127.5
Federal Tax Receipts (NIPA)	790.7	809.9	817.0	825.4	830.3	838.9	842.8	848.3	725.1	786.3	827.9	851.5	899.9
% of GNP	19.7	19.9	19.7	19.7	19.6	19.6	19.5	19.4	19.2	19.7	19.7	19.4	19.5
Federal Expenditures (NIPA)	992.0	1023.4	1019.9	1011.2	1012.6	1017.7	1033.6	1041.0	898.0	983.0	1015.4	1045.0	1111.7
% of GNP	24.7	25.1	24.6	24.1	23.9	23.8	23.9	23.8	23.8	24.6	24.1	23.8	24.1
Deficit (NIPA)	201.3	213.5	202.9	-185.8	182.3	-178.8	190.8	192.7	-172.9	196.6	187.5	193.5	211.7
% of GNP	5.00	5.20	4.90	4.40	4.30	4.20	4.40	4.40	4.60	4.90	4.50	4.40	4.60

Source: Forecast produced using Lawrence H. Meyer & Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

TABLE 2

February 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single Family Home Sales (1000's) (single family resales and completions)	4,361	4,563	4,615	4,676	4,589	4,502	4,465	4,411	3,936	4,268	4,621	4,514	4,670
Percent Change Year Ago	17.2	14.5	13.7	14.3	5.2	1.3	3.3	-6.0	5.0	8.4	8.3	-2.3	3.5
Existing Single Family Home Sales (1000's)	3,360	3,530	3,550	3,600	3,500	3,400	3,350	3,300	2,866	3,227	3,538	3,400	3,600
Percent Change Year Ago	21.6	19.0	19.5	18.1	4.2	3.7	5.6	8.3	5.5	12.6	9.6	3.9	5.9
Dollar Volume (billions)	310.5	298.6	390.4	392.4	379.4	377.4	365.0	353.1	247.1	358.8	389.1	363.8	396.2
Existing Home Prices Median ($1000's)	76.5	74.7	76.6	78.3	79.6	77.7	79.9	81.7	72.3	75.1	78.5	81.5	85.5
Percent Change -- Year Ago	4.5	3.9	3.8	4.1	4.1	4.0	4.2	4.4	3.5	3.8	4.6	3.7	4.9
Monthly Mortgage Payment(P&I 80% 30yr)	636	600	556	552	557	532	529	524	680	638	556	516	517
Percent of Median Family Income	28	27	24	23	23	22	21	21	32	29	23	21	20
Housing Starts	1,673	1,726	1,780	1,784	1,781	1,773	1,774	1,757	1,766	1,741	1,779	1,754	1,647
% Change	-20.5	13.3	13.1	0.9	0.8	-1.7	0.3	3.8	3.8	1.4	2.2	1.4	6.1
Single Family Units	1,032	1,065	1,098	1,109	1,123	1,136	1,149	1,146	1,103	1,073	1,117	1,148	1,103
Percent Change	15.1	13.3	13.0	4.2	5.0	4.8	4.7	1.3	3.5	-2.7	4.0	2.8	3.9
Multi Family Units	641	661	682	675	658	637	625	612	664	668	663	606	544
2-4 Family Units	89	83	85	84	82	80	78	76	122	95	83	76	68
% Change	48.5	24.4	13.3	4.3	9.9	-12.2	-7.2	-8.1	7.0	22.2	12.4	8.6	10.2
5+ Family Units	552	579	597	591	575	557	547	535	542	574	580	530	476
% Change	-24.2	20.5	13.3	4.3	9.9	12.2	7.2	-8.1	3.6	5.8	1.1	8.6	10.2
Mobile Homes Shipped	285	293	298	299	301	303	305	305	295	284	300	305	300
New Single Family Home Sales (1000's)	706	718	725	732	704	680	683	684	637	688	716	715	761
Percent Change - Year Ago	15.0	10.5	8.4	11.4	-0.3	-5.3	-5.8	-6.6	1.3	7.9	4.2	-0.2	6.4
New Home Prices Median ($1000's)	83.4	85.5	87.1	88.7	90.1	91.6	93.1	94.7	80.0	83.9	89.4	95.4	102.0
Percent Change Year Ago	2.5	6.4	5.1	5.6	8.0	7.2	6.9	6.8	6.0	4.9	6.5	6.7	7.0
New Home Prices -Mean ($1000's Quality A	95.4	96.4	95.9	95.7	96.7	98.7	98.4	98.5	93.7	95.5	96.3	99.7	103.8
Percent Change Year Ago	0.3	1.3	0.7	0.7	1.4	2.4	2.6	2.9	4.5	1.9	0.8	3.5	4.1
NAR Affordability Index	95.5	99.8	104.3	106.4	108.2	114.6	116.7	118.8	86.2	93.8	106.8	121.2	126.7
Mortgage Debt Outstanding ($ billions)	2,258	2,366	2,375	2,391	2,456	2,524	2,590	2,657	1,948	2,210	2,470	2,763	2,909
Housing Inventory (millions)	96.1	96.6	96.9	97.3	97.7	98.1	98.5	98.9	94.4	95.9	97.5	99.2	99.9
Rental Vacancy Rate(%)	6.8	6.3	6.3	6.3	6.3	6.3	6.2	6.1	5.9	6.4	6.3	6.2	6.0
Office Vacancy Rate (%)<1>	15.3	15.0	14.5	14.3	14.1	14.0	14.0	13.9	13.9	15.5	14.2	13.6	12.5
Industrial Vacancy Rate (%) <1>	4.5	4.5	4.3	4.2	4.0	3.9	3.6	3.4	4.7	4.5	4.1	3.5	3.0
New Commercial Building Constr.(% Ch Value)	0.1	12.1	8.8	8.2	7.7	6.6	7.9	17.5	33.7	25.6	6.8	6.6	7.7
New Industrial Building Constr.(% Ch Value)	-20.3	25.6	4.2	3.5	6.8	1.4	7.3	3.9	5.9	15.5	5.7	4.7	11.9
FINANCIAL MARKETS													
Money Supply (M1)(% change)	16.0	9.1	9.8	7.3	6.5	6.9	6.2	5.5	6.9	9.0	9.3	6.2	4.9
Velocity of M1 (% change)	-8.8	2.9	-3.2	2.2	2.4	-2.1	-1.4	1.3	3.8	2.9	3.7	1.7	0.2
Monetary Base (% change)	8.8	7.2	6.5	6.0	5.3	4.9	4.7	5.3	8.1	7.2	6.8	5.0	4.3
Value of the U.S. Dollar (Trade Weighted)	1.392	1.282	1.240	1.227	1.215	1.203	1.194	1.184	1.383	1.432	1.221	1.180	1.152
Percent Change	23.9	28.1	-12.5	4.0	4.0	4.0	-3.0	-3.0	10.4	3.5	14.7	3.4	2.4
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total gross savings)	681.9	704.7	724.1	726.7	731.2	734.3	748.4	753.7	693.3	696.8	729.1	758.5	793.8
Private Saving													
Personal Saving	102.6	118.1	127.4	124.5	124.3	123.3	135.5	134.6	172.6	129.7	124.9	135.2	152.5
Savings Rate	3.7	4.1	4.4	4.2	4.2	4.1	4.4	4.4	6.5	4.6	4.2	4.4	4.7
Gross Business Savings	579.3	586.6	596.7	602.2	606.9	611	612.9	619.1	520.7	567.1	604.2	623.3	641.3
Federal Deficit	201.3	213.5	-202.9	-185.8	-182.3	-178.8	190.8	192.7	-172.9	196.6	187.5	193.5	211.7
State & Local	56.9	56.3	55.3	52.3	47.1	44.8	42.8	40.1	64.4	58.4	49.9	38.7	35.7
Net Foreign investment	126.2	135.5	136.0	136.9	143.0	145.2	151.0	154.9	91.0	111.1	140.3	154.3	155.5
Uses (total gross investment)	666.1	685.2	713.7	735.8	741.8	750.8	754.9	756.5	674.0	670.4	735.5	758.3	773.4
Nonresidential Investment	473.7	485.4	492.5	497.0	503.6	508.5	510.1	509.4	430.3	471.8	500.4	509.4	510.8
Structures	165.8	168.4	168.8	168.9	168.7	169.5	170.3	171.0	148.7	165.7	169.0	171.2	172.7
Equipment	307.9	317.0	323.7	328.1	334.9	339.0	339.9	338.5	281.5	306.1	331.4	338.2	338.1
Residential Investment	173.1	176.7	179.0	181.3	182.7	185.5	183.9	183.8	168.4	171.5	181.6	183.5	178.8
Inventory Investment	-1.8	0.1	16.3	28.7	23.9	24.3	22.1	20.4	62.7	7.5	23.3	20.0	14.5
Selected Interest Rates (%)													
Mortgage Rates													
30 year Fixed Rate Mortgage Rate<2>	12.1	11.3	10.5	10.2	10.1	9.9	9.5	9.2	13.8	12.2	10.2	9.1	8.7
Real Mortgage Rate	9.2	8.0	6.8	7.4	7.6	7.4	6.5	6.1	9.7	8.9	7.1	6.2	4.8
1 year ARM (without buydown)	9.7	9.5	9.7	9.8	9.6	9.3	9.3	9.2	12.6	10.1	9.6	9.1	9.2
Real Mortgage Rate	6.8	6.2	6.0	7.0	7.1	6.8	6.3	6.1	8.5	6.8	6.5	6.2	5.3
Corporate AAA Bond Rate	11.0	10.6	9.9	9.6	9.5	9.3	9.0	8.7	12.7	11.4	9.6	8.6	8.2
Government Bond Rate	10.7	10.2	9.6	9.3	9.2	9.0	8.7	8.4	12.5	11.0	9.3	8.3	7.8
Real Government Bond Rate	7.8	6.9	5.9	6.5	6.7	6.5	5.7	5.3	8.4	7.7	6.2	5.4	3.9
Federal Funds Rate	7.9	8.1	7.8	7.5	7.2	7.0	6.9	6.6	10.2	8.1	7.4	6.5	7.2
3 month T Bill Rate	7.1	7.2	7.0	6.8	6.6	6.4	6.4	6.2	9.5	7.5	6.7	6.1	6.6
Real 3 Month T-Bill Rate	4.2	3.9	3.3	4.0	4.1	3.9	3.4	3.1	5.4	4.2	3.6	3.2	2.7
1 Year Treasury Bill Rate	8.0	7.8	8.0	8.1	7.9	7.6	7.6	7.5	10.9	8.4	7.9	7.4	7.5
Real 1 Year T-Bill Rate	5.1	4.5	4.3	5.3	5.4	5.1	4.6	4.4	6.8	5.1	4.8	4.5	3.6
Commercial Paper Rate	7.7	7.8	7.7	7.5	7.3	7.1	7.0	6.7	10.1	8.0	7.4	6.5	7.3
Prime Rate	9.5	9.5	9.1	8.8	8.5	8.2	8.1	7.8	12.0	9.9	8.7	7.7	8.1
Discount Rate	7.5	7.5	7.3	7.1	7.0	6.8	6.7	6.5	8.8	7.7	7.1	6.5	6.6

<1> Historical Data courtesy of Coldwell Banker

<2> FHA secondary mortgage market rate

Source: Forecast produced using Lawrence H. Meyer & Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns

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March 1986

Outlook for the Economy and Real Estate

REALTOR®

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Outlook for the Economy and Real Estate

The economic outlook for 1986 and 1987 has improved considerably over the past month due to the decline in the price of imported oil, the decline in the value of the dollar relative to the currencies of our major trading partners, and further declines in long-term interest rates. As a result, our forecast for real or inflation-adjusted Gross National Product (GNP) for 1986 has been revised up from 2.2 percent to 3.0 percent and for 1987 from 1.5 percent to 2.8 percent. However, while these developments have given the economy a needed boost, the underlying trend of a gradually weakening recovery remains in place. The threat of recession in late 1986 or 1987 appears to have been pushed back to 1988.

One year ago the spot price of oil in international markets was over $28 per barrel while currently it is below $15 per barrel due to a breakdown in OPEC's system of production quotas. This decline in the price of imported oil boosts the prospects for economic growth in several ways:

1) As the prices of gasoline, heating oil, and other petroleum-derived products decline, consumers spend less of their income on these products, leaving more of their income for purchases of other goods and services and saving. This boost to consumer spending power comes just when growth in consumption spending was waning in response to historically high consumer debt burdens.

2) Given the pervasive use of petroleum-derived products in our economy, the reduction in oil prices reduces the forecast for inflation. With reduced inflation expectations, long-term interest rates should decline (as they have), providing stimulus to residential and business investment.

3) In addition to lowering interest rates and boosting the value of bond portfolios, lower oil prices improve the profitability of oil-consuming businesses, boosting their stock prices (as has indeed happened). The increase in stock and bond prices increases household net worth and stimulates additional consumer spending.

The unexpectedly sharp decline in the dollar since last September, when the five major industrial nations announced an agreement to reduce the value of the dollar, also improves the outlook for the economy although its impact will build gradually. Already the decline in the dollar relative to currencies such as the Japanese yen has increased the cost of such products as imported automobiles and electronic equipment, discouraging their purchase by American consumers. At the same time domestically produced goods and services are more competitively priced, boosting U.S. exports. However, foreign trade currently taking place was negotiated months ago and so it will take some time for international trade flows to reflect the change in currency values. But, from this point forward the U.S. trade deficit should start to fall, boosting the domestic growth rate.

While lower oil prices and the lower value of the dollar jointly act to stimulate economic growth, they have opposite effects on inflation. Lower oil prices tend to reduce inflation, however, the reduced value of the dollar causes the prices of imported goods and services to rise and reduces downward price pressure on domestically-produced goods and services. The timing of the effects is also likely to be different, with the downward pressure from falling oil prices concentrated in 1986 while the upward pressure from the lower dollar building over time and having its greatest impact in 1987 and 1988. The forecast for inflation for 1986 (as measured by the Consumer Price Index) has been revised downward from 3.3 percent to 2.8 percent. In 1987 and 1988 inflation should then accelerate to the 3-1/2 to 4 percent range.

Even though the civilian unemployment rate rose in February to 7.3 percent from 6.7 percent in January, payroll employment continued to increase at the healthy pace of 226,000 jobs. The unemployment rate is likely to be erratic over the next few months due to changes in the way that statistic is computed and seasonally adjusted. Regardless, the improved outlook for economic growth should result in the creation of about 1.7 million jobs this year with the unemployment rate falling to the low-6 percent range toward the end of the year.

Over the past month the bond rally has continued with long-term interest rates falling another full percentage point. To add further fuel to the fire, on Thursday, March 6 the central banks of West Germany, France, and the Netherlands announced reductions in their discount rates followed the next day by similar action by Japan and a cut in the FED's discount rate from 7-1/2 percent to 7 percent. This coordinated easing of monetary policy is designed to stimulate economic growth in the major industrial economies through lower interest rates rather than deficit spending by the central governments. However, since U.S. interest rates will not decline by more than interest rates in Western Europe and Japan, this action should not prompt much additional decline in the value of the dollar. In his testimony before Congress, Chairman Volcker expressed concern about the dollar falling too much and the domestic inflationary pressures that would cause.

This further easing by the FED should allow short-term interest rates, which have been essentially flat for about six months, to trend downward about one-half percentage point over the remainder of 1986 and remain at that level through much of 1987. Long-term rates should also continue to trend downward over this period although the steep declines appear to be behind us. Long-term rates are likely to decline another one-half percentage point by the end of 1986 with additional declines in 1987 as overall economic growth slows.

Real Estate Markets

With mortgage rates down to the 10 percent level housing affordability has returned to the levels of late 1978. Builders have responded favorably, starting new housing units at a seasonally-adjusted annual rate of 2.09 million units in January, up 16 percent over December. Single-family starts were up 24 percent to a 1.35 million unit annual rate while multi-family starts were up just 2.5 percent to 735,000 units. Apparently, the threat of tax reform continues to dampen multifamily housing construction despite the significant decline in financing costs. Resales of single-family homes fell 5 percent in January to an annual rate of 3.32 million units following a 3.5 million unit pace during the last three months of 1985.

For all of 1986 a total of about 1.88 million new housing units should be started, up about 5 percent from 1985, while about 3.6 million existing single-family homes should be sold, up about 13 percent over 1985. The increase in demand should also cause home prices to rise at faster rates than during the previous three years. While overall inflation dips below 3 percent in 1986 the median sales price of existing single-family homes should rise about 5 percent compared to increases of 3-1/2 to 4 percent in 1984 and 1985.

March 1986

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4016.9	4061.5	4127.9	4190.3	4260.7	4332.1	4392.9	4444.6	3774.7	3969.1	4227.8	4474.3	4735.4
% Change	5.8	4.5	6.7	6.2	6.9	6.9	5.7	4.8	11.0	5.7	6.0	5.8	5.8
% Change (w/out inflation)	3.0	1.2	3.1	3.9	4.3	4.0	2.5	1.5	6.6	2.3	3.0	2.8	1.9
Consumption	4.6	0.1	3.1	3.1	5.1	2.4	1.0	0.8	4.4	3.5	2.9	1.8	1.7
Durables	24.3	-14.5	7.4	2.2	7.2	2.8	-1.4	-1.9	12.4	8.3	3.4	0.8	2.0
Nondurables	1.5	0.8	2.3	3.3	4.7	2.3	1.4	1.3	3.4	2.3	2.4	2.0	1.6
Services	1.4	4.8	2.3	3.3	4.7	2.3	1.4	1.3	3.0	2.5	3.1	2.0	1.6
Residential Investment	8.5	6.4	13.2	12.1	4.9	1.7	-2.2	-3.4	13.2	1.8	8.9	0.1	-0.5
Nonresidential Investmen	2.4	10.0	5.9	5.6	9.4	7.4	3.9	1.8	19.5	9.6	7.1	4.7	3.3
Structures	1.2	9.2	1.0	1.7	2.4	4.5	3.4	3.1	14.7	11.6	3.3	3.7	4.6
Equipment	3.0	10.4	8.6	7.7	13.2	8.8	4.1	1.1	22.2	8.6	9.1	5.3	2.6
Exports	-5.1	7.4	3.5	5.9	6.7	8.0	8.8	8.5	6.2	-2.9	3.2	8.2	4.9
Imports	12.8	18.6	4.8	3.5	2.6	2.3	0.6	-1.5	22.8	2.4	8.2	0.3	0.9
Government Purchases	18.2	8.5	-6.5	-7.3	-2.2	-0.1	0.1	-0.1	4.3	5.9	0.5	0.8	0.3
Contribution to GNP Growth													
Consumption	3.0	0.1	2.0	2.0	3.3	1.5	0.6	0.5	2.2	1.9	2.2	0.6	1.3
Residential Investment	0.4	0.3	0.6	0.6	0.2	0.1	-0.1	-0.2	0.2	0.3	0.4	-0.1	0.0
Nonresidential Investment	0.3	1.3	0.8	0.7	1.2	1.0	0.5	0.2	1.9	0.8	1.0	0.4	0.4
Structures	0.1	0.4	0.0	0.1	0.1	0.2	0.2	0.1	0.6	0.4	0.1	0.2	0.2
Equipment	0.3	0.9	0.7	0.7	1.1	0.8	0.4	0.1	1.3	0.4	0.8	0.2	0.2
Inventory Change ($ billions)	-1.9	-0.5	1.3	2.0	-0.4	0.9	0.6	-0.2	0.4	-1.2	1.0	0.0	0.0
Net Exports	-2.1	-1.6	-0.3	0.1	0.3	0.5	0.8	1.1	-1.5	-1.0	0.2	1.1	-0.1
Government Purchases	3.4	1.7	-1.4	-1.5	-0.4	0.0	0.0	0.0	1.5	1.4	-0.8	0.0	0.1
Mfg. Capacity Utilization Rate	80.3	79.9	80.1	80.4	80.9	81.2	81.0	80.4	80.8	80.3	80.6	80.3	79.4
Personal Income Per Household	40,040	40,613	41,082	41,504	41,969	42,435	42,952	43,364	38,175	40,029	41,740	43,561	45,550
% Change -- Year Ago	3.7	3.8	3.9	4.0	4.8	4.5	4.5	4.5	5.4	4.8	4.3	4.3	4.6
Personal Taxes Per Household	6,049	6,157	6,155	6,246	6,346	6,444	6,456	6,543	5,420	5,988	6,297	6,586	7,059
% Change	3.1	1.8	-0.0	1.5	1.6	1.5	0.2	1.3	-17.2	10.5	5.2	4.6	7.2
% of Personal Income	15.1	15.2	15.0	15.0	15.1	15.2	15.0	15.1	14.2	15.0	15.1	15.1	15.5
Disposable Personal Income Per Household	33,992	34,456	34,927	35,258	35,623	35,990	36,496	36,821	32,755	34,040	35,443	36,975	38,491
% Change -- Year Ago	3.5	3.6	4.5	2.8	4.8	4.4	4.5	4.4	5.7	3.9	4.1	4.3	4.1
Employment (millions)	115.5	116.2	116.5	117.0	117.4	117.8	118.2	118.6	113.5	115.5	117.2	118.8	120.0
(civilian:household basis)													
% Change	1.1	2.4	1.4	1.4	1.5	1.4	1.4	1.3	1.8	1.7	1.5	1.4	1.0
Unemployment Rate (%) (civilian)	7.2	7.0	6.7	6.6	6.4	6.2	6.1	6.3	7.5	7.2	6.5	6.3	6.0
Consumer Prices (CPI)	2.3	4.1	2.1	2.3	2.7	3.5	3.9	3.9	4.3	3.5	2.8	3.6	4.1
GNP Deflator	2.9	3.3	3.5	2.2	2.5	2.7	3.1	3.3	4.1	3.3	2.9	3.0	3.8
Personal Cons. Inflation	-2.2	4.0	2.3	2.4	2.6	3.4	3.8	3.8	4.1	3.2	2.8	3.5	3.9
Residential Construction	1.1	4.9	3.5	2.6	2.9	3.4	3.9	3.9	4.2	1.8	3.0	3.7	4.2
Nonresidential Const. Inflation	1.2	0.8	4.4	2.4	2.7	2.9	3.5	3.6	0.5	1.4	2.4	3.3	3.5
Producer Price Inflation	-0.8	4.7	-0.1	1.6	2.5	4.1	4.5	4.5	2.1	0.9	1.7	4.0	4.3
Before Tax Corporate Profit	228.6	235.5	226.9	236.1	246.0	258.6	256.9	253.4	237.6	225.7	241.9	255.4	240.9
Corporate Tax Liability	87.5	90.0	86.3	90.4	94.5	100.0	98.9	97.1	93.6	85.8	92.8	97.9	90.0
After Tax Profits	141.1	145.5	140.6	145.7	151.5	158.6	158.0	156.3	144.0	139.9	149.1	157.5	150.9
Inventory Valuation Adjustment	4.7	-10.0	-3.1	-8.8	-11.0	-16.7	-18.6	-19.3	-5.4	-0.6	-9.9	-20.0	-18.3
Capital Consumption Allowance	75.9	83.0	87.6	93.4	99.0	104.6	109.9	115.1	41.0	71.8	96.2	117.7	137.0
Federal Tax Receipts (NIA)	790.7	805.9	814.4	827.6	842.0	857.8	866.3	874.1	725.1	785.3	835.5	879.4	921.2
% of GNP	19.7	19.8	19.7	19.8	19.8	19.8	19.7	19.7	19.2	19.7	19.8	19.7	19.5
Federal Expenditures (NIA)	992.0	1028.4	1022.5	1011.5	1013.0	1018.3	1034.7	1042.9	898.0	984.2	1016.3	1046.5	1085.2
% of GNP	24.7	25.3	24.8	24.1	23.8	23.5	23.6	23.5	23.8	24.7	24.0	23.4	22.9
Deficit (NIA)	-201.3	-222.5	-208.1	-183.8	-171.0	-160.5	-168.4	-168.7	-172.9	-198.9	-180.9	-167.0	-164.1
% of GNP	5.0	5.5	5.0	4.4	4.0	3.7	3.8	3.8	4.6	5.0	4.3	3.7	3.5
% of Net Domestic Savings	67.7	72.4	65.1	57.3	52.4	48.2	48.9	49.0	51.1	63.0	55.6	48.4	47.3

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

TABLE 2

March 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4.377	4.535	4.665	4.714	4.760	4.769	4.800	4.804	3.933	4.254	4.727	4.861	4.790
Percent Change -- Year Ago	17.2	18.5	16.0	15.5	8.8	5.1	2.9	1.9	5.1	8.2	11.1	2.8	-1.4
Existing Single-Family Sales (1000's)	3,360	3,500	3,529	3,595	3,666	3,702	3,742	3,755	2,866	3,215	3,623	3,796	3,705
Percent Change -- Year Ago	21.6	24.4	19.4	18.1	9.1	5.8	6.0	4.4	5.7	12.2	12.7	4.8	-2.4
Dollar Volume (billions)	310.5	318.0	327.9	341.2	355.4	350.1	368.4	384.9	247.1	290.9	343.6	382	393
Existing Home Prices - Median ($1000's)	76.6	75	77.3	78.6	80.4	78.6	81.5	83.1	72.9	75.1	78.8	83.1	87.2
Percent Change Year - Ago	4.6	4.2	4.7	4.8	4.9	4.8	5.4	5.5	3.6	3.9	4.9	5.5	4.9
Monthly Mortgage Payment (P&I, 80%, 30 yr)	614.4	562.7	531.9	520.2	525	500.8	516.1	513.4	665.1	611.9	519.5	502.5	497.1
Percent of Median Family Income	24	21	20	19	19	18	18	18	27	24	19	18	17
Housing Starts	1,688	1,747	1,897	1,905	1,874	1,829	1,805	1,786	1,763	1,735	1,876	1,803	1,799
% Change	-3.0	3.5	8.5	0.4	-1.6	-2.4	-5.1	-4.1	3.4	-1.6	8.2	-3.9	-0.2
Single-Family Units	1,048	1,070	1,171	1,154	1,128	1,100	1,091	1,082	1,100	1,072	1,138	1,096	1,119
Percent Change	-1.9	2.1	9.4	-1.4	-2.2	-2.4	-0.8	-0.8	3.3	-2.6	6.2	-3.7	2.1
Multi-Family Units	639	677	726	751	746	730	715	704	663	663	738	706	680
2-4 Family Units	89	81	86	90	89	87	85	84	122	93	88	84	81
% Change	-12.0	-9.1	6.2	4.6	-1.1	-2.2	-2.3	-1.2	7.9	-23.7	-5.4	-4.3	-3.7
5+ Family Units	550	596	639	662	657	643	630	621	542	570	650	622	599
% Change	3.8	8.3	7.2	3.6	-0.7	-2.1	-2.0	-1.4	2.8	5.2	14.0	-4.3	-3.7
Mobile Homes Shipped	285	290	303	301	298	295	295	294	295	283	299	296	300
New Single-Family Home Sales (1000's)	711	692	717	727	756	757	737	750	636	687	739	756	751
Percent Change -- Year Ago	15.0	11.0	7.2	10.6	6.3	9.4	2.3	3.2	6.1	8.0	7.5	2.3	-0.6
New Home Prices - Median ($1000's)	82.8	85.5	87.6	89.0	90.1	91.2	92.3	93.5	80.0	83.8	89.5	94.2	100.2
Percent Change -- Year Ago	1.8	6.5	5.7	6.0	8.8	6.7	5.4	5.1	6.1	4.8	6.8	5.2	6.4
New Home Prices--Mean (Quality Adjusted)	104.3	106.4	102.1	105.3	106.2	109.6	105.2	108.8	96.8	104	105.8	109.6	114.1
Percent Change -- Year Ago	7.3	7.5	1.0	3.1	2.3	3.0	3.0	3.3	6.6	7.4	1.7	3.6	4.1
NAR Affordability Index	90.8	99.3	104.8	108.2	108.2	110.6	112.6	114.3	89.1	95.5	109.0	117.5	124.0
Mortgage Debt Outstanding ($ billions)	2,224	2,386	2,331	2,392	2,455	2,421	2,587	2,653	1,948	2,202	2,400	2,687	2,954
Housing Inventory (millions)	95.4	95.8	96.3	92.8	93.3	93.7	94.2	94.6	93.4	95.2	94.0	94.8	96.6
Rental Vacancy Rate(%)	6.8	6.7	6.7	6.8	6.8	6.7	6.7	6.8	5.8	6.5	6.8	6.7	6.7
Office Vacancy Rate (%) <1>	16.2	16.5	16.6	16.8	16.8	16.9	17.0	16.8	13.9	16.0	16.8	16.8	16.4
Industrial Vacancy Rate (%) <1>	4.8	4.9	4.9	4.8	4.6	4.5	4.3	4.3	4.7	4.7	4.7	4.3	4.0
New Commercial Building Const. (% Ch Value)	59.8	61.6	10.7	1.9	7.9	-11.2	-11.3	-17.6	47.8	60.0	2.3	-10.5	1.3
New Industrial Building Const. (% Ch Value)	15.4	16.3	-6.4	5.0	7.2	2.5	5.3	3.9	13.7	15.8	2.1	4.9	9.2
FINANCIAL MARKETS													
Money Supply (M1)(% change)	15.7	11.0	7.7	6.8	7.1	6.8	5.8	5.1	6.9	9.1	9.1	6.2	5.5
Velocity of M1 (% change)	-8.6	-5.8	-0.9	-1.5	-1.1	-1.1	.0.1	0.2	3.8	-3.1	-3.3	-0.5	0.4
Value of the U.S. Dollar (Trade-Weighted)	1.39	1.28	1.20	1.17	1.16	1.15	1.14	1.12	1.38	1.43	1.17	1.12	1.17
Percent Change	-23.9	-28.1	-23.2	-9.6	-4.0	-4.0	-4.0	-4.0	10.4	3.5	-18.4	-4.6	4.9
Flow of Funds (NIA Basis) (Billions of dollars, saar)													
Sources: (total: gross savings)													
Private Saving	682	698	721	726	737	747	768	779	693	695	733	785	821
Personal Saving	103	116	125	123	120	121	130	130	173	129	122	128	113
Savings Rate	3.7	4.1	4.3	4.2	4.1	4.0	4.3	4.2	6.5	4.6	4.2	4.1	3.5
Gross Business Savings	579	582	596	603	616	626	638	649	521	566	610	658	707
Federal Deficit	-201	-223	-208	-187	-177	-171	-176	-177	-173	-199	-186	-174	-170
State & Local	57	58	56	55	56	56	57	56	64	59	56	56	64
Net Foreign Investment	-126	-145	-146	-140	-142	-141	-141	-139	-91	-114	-142	-137	-133
Uses (total: gross investment)	666	678	709	736	757	773	785	794	674	669	744	800	851
Nonresidential Investment	474	485	492	497	507	514	518	521	430	472	503	524	542
Structures	166	170	170	170	171	172	173	175	149	166	171	176	185
Equipment	308	316	322	327	336	342	345	346	282	306	332	348	358
Residential Investment	173	176	181	186	187	186	184	183	168	171	185	184	185
Inventory Investment	-1.8	-6.7	5.2	16.7	21.2	25.9	28.6	29.7	62.7	5.6	17.2	28.5	29.0
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage	12.1	11.3	10.3	9.9	9.8	9.6	9.5	9.3	13.8	12.2	9.9	9.1	8.6
Real Mortgage Rate	9.2	8.0	6.8	7.7	7.5	7.0	6.5	6.2	9.7	8.9	7.0	6.3	4.9
1-year ARM (without buydown)	9.7	9.5	9.3	9.2	9.2	9.1	9.0	8.7	12.6	10.1	9.2	8.8	8.8
Real Mortgage Rate	6.8	6.2	5.8	7.0	6.9	6.5	6.0	5.6	8.5	6.8	6.3	6.0	5.1
Corporate AAA Bond Rate	11.0	10.6	9.8	9.5	9.4	9.2	8.9	8.7	12.7	11.4	9.5	8.5	7.9
Government Bond Rate	10.7	10.2	9.2	9.0	8.8	8.7	8.5	8.2	12.5	11.0	8.9	8.0	7.4
Real Government Bond Rate	7.8	6.9	5.7	6.8	6.5	6.1	5.5	5.1	8.4	7.7	6.0	5.2	3.7
Federal Funds Rate	7.9	8.1	7.8	7.6	7.3	7.2	7.3	7.0	10.2	8.1	7.5	6.7	6.7
3-Month T-Bill Rate	7.1	7.2	7.1	6.8	6.5	6.5	6.6	6.5	9.5	7.5	6.7	6.2	6.3
Real 3-Month T-Bill Rate	4.2	3.9	3.6	4.6	4.2	3.9	3.6	3.4	5.4	4.2	3.8	3.4	2.6
1 Year Treasury Bill Rate	8.0	7.8	7.6	7.5	7.5	7.4	7.3	7.0	10.9	8.4	7.5	7.1	7.1
Real 1 Year T-Bill Rate	5.1	4.5	4.1	5.3	5.2	4.8	4.3	3.9	6.8	5.1	4.6	4.3	3.4
Prime Rate	9.5	9.5	9.5	9.4	9.1	8.8	8.9	8.7	12.0	9.9	9.2	8.4	8.2
Discount Rate	7.5	7.5	7.4	7.5	7.1	7.0	6.6	6.6	8.8	7.7	7.2	6.4	6.3

<1> Historical Data courtesy of Coldwell Banker.

<2> FHA secondary mortgage market rate.

Source: Forecast produced using Laurence H. Meyer & Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

Economic Impacts of The Gramm-Rudman-Hollings Deficit Reduction Legislation

On December 11, Congress passed and the President signed the Balanced Budget and Emergency Deficit Control Act of 1985, otherwise known as the Gramm-Rudman-Hollings (GRH) proposal. This legislation, sponsored by Senators Gramm (R., Texas), Rudman (R., New Hampshire) and Hollings (D., South Carolina), establishes a path of shrinking deficits starting in FY1986. The mandated deficit targets are as follows: $172 billion in FY1986, $144 billion in FY1987, $108 billion in FY1988, $72 billion in FY1989, $36 billion in FY1990, and a balanced budget in 1991. The Administration is constrained by these deficit limits in formulating the annual budget that is submitted to the Congress. Similarly, Congressional budget resolutions are required to adhere to these targets.

On March 1, 1986 and then on each following September 1, the Congressional Budget Office (CBO) and the Administration's Office of Management and Budget (OMB) are required to prepare estimates of the deficit for the remainder of FY1986 or the following fiscal year, taking into account expected economic conditions and Congressional budget actions as of that date. These estimates are to be submitted to the Comptroller General of the General Accounting Office (GAO) who is to review the estimates and resolve differences. If GAO determines that the projected deficit exceeds the target for the fiscal year by more than $10 billion, the President would be required to make automatic spending reductions to achieve that target if Congress and the President are unable to agree on an alternative plan by October 15. Defense would take half of the automatic spending cuts while domestic programs would take the other half, with Social Security, interest on the debt, and the primary low-income programs exempt. Note that while the automatic feature of the bill calls for spending reductions only, taxes could be increased as part of an alternative plan to achieve the deficit target.

Also included in the bill is a provision for waiving this procedure in the event of a weak economy. If CBO or OMB project two consecutive quarters of negative growth in real or inflation-adjusted Gross National Product (GNP) or if the Department of Commerce reports that real GNP growth during the current quarter and the immediately preceeding quarter is less than 1 percent, the deficit target is waived for the remainder of the current fiscal year and/or the following fiscal year.

Provided the Federal Reserve Board (FED) acts quickly to offset the decline in aggregate demand resulting from the cuts in federal spending with lower interest rates brought on by a more accommodative monetary policy, deficit reduction through spending cuts would have very desirable impacts on overall economic performance. As shown in Table 1, as the federal governments borrowing requirements decline savings now being absorbed by the deficit would be available to the private sector, thus allowing interest rates to decline. Lower interest rates would have numerous beneficial impacts--increased activity in the interest-sensitive sectors of the economy such as housing and business investment, a reduced value of the dollar which would allow a steady decline in the U.S. trade deficit, and further reductions of the federal deficit by reducing interest payments on the outstanding federal debt. By the end of the decade housing starts would be up by about 260,000 units or 14 percent. Nonresidential fixed investment would increase by about 10 percent. Within five years total employment would increase by over a million jobs while real GNP would be up by about 1-1/2 percent. The only negative effect would be an increase of inflation of about one percentage point. This would be due primarily to the reduced value of the dollar which would boost the cost of imported goods and services and diminish price pressure on domestic producers. However, this increase in inflation would subside as the dollar stabilized at its new lower value. Without an accommodative shift in monetary policy, the reduction in federal spending prescribed by GRH would cause weakness in the economy. However, that fact plus continued low inflation would likely induce the FED to provide the needed stimulus.

Table 1

Macroeconomic Impacts of the Gramm-Rudman-Hollings Proposal with Accommodative Monetary Policy[1]
(percent change from baseline)

	1986	1987	1988	1989	1990	1991
Real GNP	0.1	0.7	1.0	1.2	1.2	1.5
Inflation (Percentage Points)	0.0	0.2	0.5	0.7	0.8	0.9
Employment (Millions of Jobs)	0.0	0.2	0.4	0.6	0.7	1.1
Mortgage Rate (Percentage Points)	-0.6	-1.3	-1.7	-1.8	-1.9	-2.0
Housing Starts (Thousand of Units)	84.7	199.6	259.1	261.9	219.3	148.9
% Change	4.4	10.1	13.7	14.1	11.7	7.9
Single Family	51.5	113.3	138.0	126.9	91.7	46.2
% Change	4.4	9.2	11.5	10.6	7.6	3.8
Multi-Family	32.7	86.3	121.1	135.0	127.6	102.7
% Change	4.4	11.6	17.6	20.5	19.4	15.7
Nonresidential Investment						
Equipment	0.5	2.7	5.4	7.8	9.3	9.7
Structures	0.3	1.9	4.3	6.9	9.4	11.7

Source: NATIONAL ASSOCIATION OF REALTORS®

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[1] Note: For this simulation deficit reduction is achieved through slower federal spending growth only with half the reduction from defense and half from the nondefense programs not exempt from GRH cuts.

Unfortunately, this desirable scenario is unlikely to come about due to the inability to reach a political consensus on the required reductions in spending growth. The President will likely resist deep cuts in defense spending while House Democrats will likely resist deep cuts in social programs. This leaves two options--either tax increases or GRH will be subverted or repealed through future legislation. At this point it seems reasonable to expect that some deficit reduction will occur in roughly the following proportions-1/3 from defense, 1/3 from nondefense programs, and 1/3 from increased taxes. Given the current sentiment in Washington the increase in tax revenues is most likely to be gained by imposing higher taxes on business investment such as lengthening of depreciation schedules and reducing or eliminating the investment tax credit rather than by an across-the-board increase in personal tax rates. However, as the following economic simulations reveal, if a tax increase is to occur an increase in personal taxes would be the least damaging to the economy over the long-run.

Table 2 shows the economic impacts of deficit reduction through a combination of an increase in business taxes and slower growth of federal spending. Business taxes are raised by halving the investment tax credit (ITC) for both equipment and structures and lengthening the recovery periods for equipment from an average of 4.6 to 9.2 years and for structures from 19 to 30 years. Despite an easier monetary policy real GNP growth declines substantially by the end of the decade. Mortgage rates decline about 1-1/2 percentage points due to reduced government borrowing and the slower growth of the economy, however, the resulting increase in housing starts is about 60 percent of the increase in the no tax increase case since interest rates have declined less and because employment and household income are lower. Nonresidential investment declines severely throughout the period, with spending for structures down over 6 percent and spending for equipment dropping more than 15 percent as a direct result of the loss in value of depreciation deductions and the investment tax credit. The level of real GNP is about 3 percent lower by 1991 with about 500,000 fewer jobs.

The decline in mortgage interest rates is less than in the no tax increase case because reducing depreciation deductions and investment tax credits to increase tax receipts has the simultaneous effect of reducing business savings. Thus, while the deficit is declining total domestic savings is also declining substantially. In this scenario, spending by the federal government permanently crowds out private investment. The slower growth of capital formation results in slower growth potential of the economy, resulting in fewer jobs and lower real incomes.

Table 3 presents the economic impacts of deficit reduction through an increase in personal taxes combined with slower growth of federal spending. Personal tax revenues are increased through a 10 percent increase in federal tax rates each years from 1986 through 1991. Note that while the overall impact on real GNP and employment is still negative, the impact is considerably less severe than with an increase in business taxes. By 1991 real GNP is below the baseline by about 1 percent while employment is down by about 300,000 jobs due to a contraction in consumption spending. Investment in equipment is up about 5-1/2 percent while investment in nonresidential structures is up nearly 7 percent. Over the total six year period housing starts have increased significantly more than in the business tax increase case while they are about 30 percent below the no tax increase case.

The favorable impact on residential and nonresidential investment is due to the significant decline in interest rates. (In fact, interest rates are down more than in the no tax increase case, although that is due to the fact that real GNP increased in that case while it declined in this case). Interest rates would decline more in the case of a personal tax increase than in the case of a business tax increase since only a small percentage of each dollar raised through a personal tax increase would have been saved. Thus, the deficit is reduced by a much greater percentage than is domestic savings, so that the deficit as a percent of domestic savings falls sharply.

Conclusion

It is generally recognized that deficit reduction is important for the long-term health of the economy. However, the way in which the deficit is reduced is equally important. Deficit reduction through slower growth of federal spending is definitely the best course for the economy but appears to be politically unattainable. Therefore, if tax increases are required as a second best alternative, we should choose that form of tax increase that would do the least damage to the nation's long-run growth potential.

Table 2

Macroeconomic Impacts of the Gramm-Rudman-Hollings Proposal with a Business Tax Increase and Accommodative Monetary Policy[1]
(percent change from baseline)

	1986	1987	1988	1989	1990	1991
Real GNP	0.2	0.3	-0.2	-1.1	-2.2	-3.2
Inflation (Percentage Points)	0.0	0.2	0.4	0.6	0.7	0.8
Employment (Millions of Jobs)	0.0	0.1	0.0	-0.2	-0.4	-0.5
Mortgage Rate (Percentage Points)	-0.4	-0.9	-1.2	-1.4	-1.5	-1.5
Housing Starts (Thousand of Units)	69.7	153.0	177.7	155.2	100.0	28.3
% Change	3.7	7.7	9.4	8.4	5.4	1.5
Single Family	42.5	86.6	93.6	71.0	31.2	-14.0
% Change	3.7	7.0	7.8	6.0	2.6	-1.1
Multi-Family	27.2	66.3	84.2	84.3	68.8	42.2
% Change	3.7	8.9	12.2	12.8	10.5	6.5
Nonresidential Investment						
Equipment	0.7	-0.2	-3.9	-8.3	-12.4	-15.3
Structures	0.5	0.8	-0.2	-1.6	-4.0	-6.5

Source: NATIONAL ASSOCIATION OF REALTORS®

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[1] Note: For this simulation, the investment tax credits for equipment and structures were both cut in half and the average recovery periods for equipment and structures were lengthened to 9.2 and 30.0 years, respectively. Federal spending was cut using the guidelines set out in the Gramm-Rudman-Hollings law. In 1986, the increase in business tax receipts contributes 42 percent of the deficit reduction necessary to reach the GRH target, while cuts in defense and nondefense spending contribute 31 percent and 27 percent, respectively. By 1991, these figures are 29 percent attributable to business tax increases, 39 percent from defense spending cuts and 32 percent from nondefense spending cuts.

Table 3

Macroeconomic Impacts of the Gramm-Rudman-Hollings Proposal with a 10% Personal Tax Rate Increase and Accommodative Monetary Policy[1]

(percent change from baseline)

	1986	1987	1988	1989	1990	1991
Real GNP	-0.3	-0.4	-0.5	-0.6	-0.8	-1.0
Inflation (Percentage Points)	0.0	0.0	-0.1	-0.2	-0.3	-0.3
Employment (Millions of Jobs)	-0.2	-0.3	-0.3	-0.2	-0.2	-0.3
Mortgage Rate (Percentage Points)	-0.5	-1.1	-1.6	-2.0	-2.3	-2.5
Housing Starts (Thousand of Units)	59.9	122.5	167.5	181.8	170.1	140.2
% Change	3.2	6.2	8.8	9.8	9.1	7.5
Single Family	40.9	70.5	89.7	88.9	73.9	51.7
% Change	3.5	5.7	7.4	7.5	6.1	4.2
Multi-Family	19.0	52.0	77.8	92.9	96.2	88.5
% Change	2.6	7.0	11.3	14.1	14.7	13.5
Nonresidential Investment						
Equipment	-0.2	0.3	1.6	3.1	4.6	5.5
Structures	-0.2	0.2	1.2	2.7	4.7	6.8

Source: NATIONAL ASSOCIATION OF REALTORS®

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[1] Note: For this simulation a personal tax increase was imposed by raising the average federal personal tax rate 10 percent per year beginning in 1986 and continuing through 1991. Federal spending was cut using the guidelines set out in the Gramm-Rudman-Hollings law. Beginning in 1986, the increase in personal tax receipts contributes 76 percent of the deficit reduction necessary to reach the GRH target, while cuts in defense spending and nondefense spending each contribute 12 percent. By 1991, these figures are 14 percent attributable to personal tax increases, and defense and nondefense spending each contributing 43 percent.

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Outlook for the Economy and Real Estate

REALTOR®

Forecasting & Policy
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The Outlook For the Economy and Real Estate

It appears that growth has been fairly weak so far this year with real GNP growth of only 2.5 percent expected for the first quarter of 1986. A persistently large trade deficit played a major role in dampening overall economic activity. Domestic producers, unable to compete against cheap imports in international markets, continue to experience losses in profits and employment. Many have had to cut back on the amount of plant capacity used resulting in a decline in the manufacturing capacity utilization rate since January. Auto sales have also remained weak since January, mainly due to expiration of cut rate financing incentives. In response, the auto industry has begun to cut back on production in attempts to reduce swelling inventories. Further, the government will spend less this year in order to reach deficit targets imposed by Gramm-Rudman-Hollings. These constraints on production and spending should continue to restrain real growth in output to 3.1 percent in the second quarter. However, during the second half of 1986, the sharp declines in imported oil prices, a further depreciation of the dollar and continued declines in long-term interest rates are expected to provide a much-needed stimulus, boosting real GNP growth to 3.5 percent. For all of 1986, real output growth should increase almost 2.5 percent, the second consecutive year of below average growth. The rebound late in 1986 is unlikely to be sustained and growth should again begin to weaken by late 1987. For all of 1987 growth should increase about 3 percent.

As the year progresses, consumer spending should strengthen considerably despite record levels of consumer debt and an already anemic savings rate. Currently, the only area of consumer spending recording any gains has been services while spending on durable and nondurable goods has been declining. By mid-year, however, spending on goods should start to increase as lower prices for imported oil positively impact real (inflation-adjusted) personal income and net worth of consumers. Simply, consumers will spend less on oil and oil-related products leaving more money in their pockets for consumption of other goods and services. In addition, lower oil prices have and will continue to lead to a downward revision of inflation expectations resulting in further declines in long-term interest rates. Lower interest rates, which have already provided a strong stimulus to the housing sector, should continue to boost spending in the interest sensitive industries of consumer durables and housing through 1986. Further, debt burdens that currently restrain spending should be substantially reduced as long-term obligations are refinanced at these lower interest rates. Finally, rising confidence that real profits will increase given a lower level of inflation has contributed to a sustained rally in the stock market resulting in a rise in household net worth. This will enlarge the pool of funds needed to support consumer spending through 1986.

However, lower oil prices will not benefit everyone. Both domestic and foreign corporations that are heavily dependent on the energy sector should be especially hard hit as lower oil prices reduce profits and employment through 1987. Banks holding loans for energy companies and energy related products will also be financially strained.

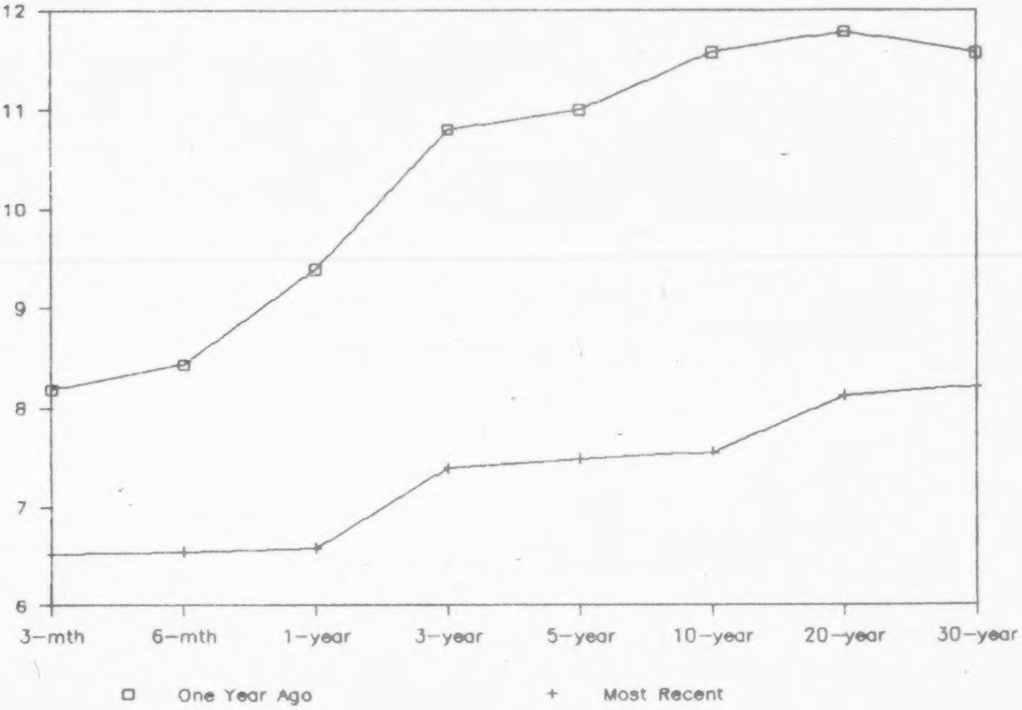
The U.S. trade deficit is expected to shrink later this year given recent declines in the value of the dollar relative to other currencies. Over the past few years, a strong dollar has made goods and services produced outside the U.S. relatively cheaper than their domestic counterparts. As a result, import demand has flourished while export demand has weakened considerably. Because U.S. imports have far exceeded exports, a negative merchandise trade balance or trade deficit has resulted. This trade deficit reached 150 million dollars in 1985. However, the continued depreciation in the dollar through 1986 is expected to improve the competitive position of domestic producers by reducing the cost of U.S. goods and services in international markets while raising the cost of imported goods and services for U.S. consumers and businesses. Over the past 12 months the dollar has depreciated 30 percent. As import prices rise relative to our exports, demand for U.S. goods abroad will intensify; thus increasing exports. At the same time, Americans will be encouraged to buy American-made goods; thus dampening U.S. demand for imports. This already has had some positive impact on the trade deficit in February as the monthly trade deficit of $12.5 billion was $1.5 billion less than the $14 billion trade deficit reported in January. While some of this decline may be due to seasonal adjustments, the merchandise trade deficit is expected to contine to slowly shrink through 1986 as export growth outpaces growth in imports providing a major stimulus to economic activity during the last half of the year.

The short-term outlook for inflation remains favorable. The sharp decline in imported oil prices was largely responsible for the decline of 0.4 percent in the Consumer Price Index (CPI) in February, the largest monthly fall in 32 years. In addition, the Producer Price Index (PPI) has declined by 2 percent over the past two months. The decline in oil prices is likely to promote further easing of inflation this year as lower oil prices work their way through the economy. In fact, for 1986, we anticipate an increase in the CPI of only 2.5 percent, down from 3.5 percent in 1985. This should help future inflation as well by reducing wage demands. However, the decline in the price of oil provides only a one-time slowing of inflation. Once lower oil prices have worked their way through the economy, underlying inflationary forces should become apparent. For example, excluding the food and energy sector the CPI actually increased at an annual rate of 4 percent in February reflecting rising inflation in the service sector. By 1987, the downward pressure on prices from earlier declines in oil prices will have dissappeared, and the upward pressure on prices from a declining dollar will dominate. Therefore, by next year a modest reacceleration of inflation is expected with the CPI increasing 3.2 percent in 1987 and 4.0 percent in 1988.

The civilian unemployment rate edged down slightly to 7.2 percent in March. Yet, it still remains well above the 6.7 percent rate recorded last January. A modest 190,000 increase in total nonagricultural employment in March was entirely attributable to strength in the service sector while employment in the goods-producing sector actually declined by 42,000 workers. Some of the decline in manufacturing employment reflect losses in the energy producing sectors. But a majority of the decline in employment in the goods producing sector underscores the persistent shift in demand away from domestically produced goods towards services and relatively cheaper foreign produced imports. The employment figure was another sign that the drop in the value of the dollar would not benefit domestic producers right away. It will take time for the manufacturing sector to respond to the increased demand for domestically produced goods that is expected to occur later this year as the dollar continues to depreciate. Therefore, growth in employment is expected to remain flat through 1986 holding the unemployment rate near 7.0 percent.

The outlook for interest rates remains bright. A confident bond market continues to rally pushing long-term government bond rates to below 7.5 percent, a little over one and a half percentage points above the 3 month Treasury bill rate. A year ago this spread between long- and short-term interest rates was three and a half percentage points. The convergence between long- and short-term rates underscores confidence among investors that inflation is moderate and not likely to accelerate and that the deficit problem could soon be diminished as evidenced by passage and partial implementation of Gramm-Rudman-Hollings. This is evident in the substantial flattening of the yield curve as seen in Figure 1. Interest rates are expected to continue to trend downward through the end of 1986 with some further easing by the Federal Reserve Board (FED) likely in the next few months. However, rates should stabilize in 1987 due to a somewhat stronger economy and signs of increasing inflation. By late 1987, a rebound in inflation coupled with a weakening economy will pose a difficult challenge to the FED. A tighter stance by the FED in order to prevent acceleration of inflation would be inconsistent with the need for lower interest rates to stimulate the economy.

Figure 1
Yield Curve



Real Estate Markets

With mortgage rates already reaching single digits in some areas, affordability has greatly improved, providing a strong stimulus to the housing industry. The NAR Affordability Index remained above 100 for the third consecutive month in February. During the last three months alone housing affordability has been better that at any other time during the last seven years. In February, existing home sales remained near 3.3 million units. As mortgage rates continue to fall over the course of the year, over 3.5 million existing homes are expected to be sold for all 1986, up 10.1 percent from 1985. The outlook for housing starts remains mixed. Single-family housing starts, which currently exhibit strong monthly gains, are expected to fare quite favorably this year as affordability improves and builders remain optimistic about economic growth. For all of 1986, 1.2 million single family units should be started. Multi-family starts, on the other hand, after experiencing a volatile year in 1985, should remain near 700,000 as uncertainty over tax reform chills this market despite the significant declines in financing costs.

APRIL 1986

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4016.9	4059.3	4120.9	4170.2	4226.2	4287.5	4350.8	4415.3	3774.7	3988.6	4201.2	4440.3	4720.8
% Change	5.8	4.3	6.2	4.9	5.5	5.9	6.0	6.1	11.0	5.7	5.3	5.7	6.3
% Change (w/out inflation)	3.0	0.7	2.5	3.1	3.5	3.6	3.3	3.2	6.6	2.2	2.5	3.1	2.9
Consumption	4.6	0.1	2.2	3.5	2.4	2.1	2.2	1.5	4.4	3.3	2.4	1.9	1.9
Durables	24.3	-13.3	2.5	5.8	3.8	1.1	2.8	-0.6	12.4	8.4	2.7	1.3	2.3
Nondurables	1.5	0.6	2.0	3.1	2.2	2.3	2.1	1.8	3.4	2.3	2.0	2.0	1.9
Services	1.4	4.4	2.3	3.1	2.2	2.3	2.1	1.8	3.0	2.5	2.6	2.0	1.9
Residential Investment	8.5	5.7	15.8	15.3	7.2	4.3	0.9	-1.8	13.2	1.7	10.5	1.8	-2.5
Nonresidential Investment	2.4	11.3	3.5	4.8	5.1	4.8	5.1	4.3	19.5	9.7	5.8	4.7	4.7
Structures	1.2	7.2	1.9	4.3	5.3	4.9	5.0	5.5	14.7	11.4	4.1	4.9	3.7
Equipment	3.0	13.5	4.4	5.0	5.0	4.7	5.2	3.7	22.2	8.8	6.8	4.6	5.2
Exports	-5.1	6.6	3.7	6.6	6.2	6.0	7.1	7.7	6.2	-3.0	3.1	7.1	8.2
Imports	12.8	24.5	3.8	1.5	-0.1	-0.3	-0.7	-0.8	22.8	2.7	8.0	-0.8	-0.7
Government Purchases	18.2	9.2	-7.9	-7.1	-2.1	0.2	0.4	0.2	4.3	6.0	0.3	-0.5	0.8
Contribution to GNP Growth													
Consumption	3.0	0.1	1.4	2.2	1.6	1.4	1.4	0.9	2.2	1.9	1.7	0.8	1.7
Residential Investment	0.4	0.3	0.7	0.7	0.4	0.2	0.0	-0.1	0.2	0.3	0.5	-0.1	0.0
Nonresidential Investment	0.3	1.4	0.5	0.6	0.7	0.6	0.7	0.6	1.9	0.8	0.6	0.6	0.7
Structures	0.1	0.3	0.1	0.2	0.2	0.2	0.2	0.3	0.6	0.4	0.2	0.2	0.2
Equipment	0.3	1.1	0.4	0.4	0.4	0.4	0.5	0.3	1.3	0.5	0.4	0.3	0.5
Inventory Change ($ billions)	-1.9	-0.5	1.7	0.5	0.7	0.6	0.3	0.8	0.4	-1.2	0.9	0.2	0.1
Net Exports	-2.1	-2.3	-0.2	0.4	0.6	0.6	0.8	0.9	-1.5	-1.2	0.4	1.0	0.7
Government Purchases	3.4	1.8	-1.7	-1.5	-0.4	0.0	0.1	0.0	1.5	1.5	-0.9	0.0	0.2
Mfg. Capacity Utilization Rate	80.3	80.1	79.8	79.9	80.1	80.5	80.7	81.0	80.8	80.3	80.1	80.8	61.5
Personal Income Per Household	40,040	40,616	40,921	41,252	41,604	41,956	42,401	42,791	37,077	39,143	40,816	42,624	44,883
% Change -- Year Ago	3.7	3.8	3.6	3.9	3.9	3.3	3.6	3.4	5.4	5.6	4.3	4.4	5.2
Personal Taxes Per Household	6,049	6,156	6,154	6,228	6,308	6,387	6,384	6,468	5,264	5,855	6,176	6,453	6,980
% Change	1.3	1.8	-0.0	1.2	1.3	1.3	-0.0	1.3	12.2	11.2	5.5	4.5	8.2
% of Personal Income	15.1	15.2	15.0	15.1	15.2	15.2	15.1	15.1	14.2	15.0	15.1	15.1	15.6
Disposable Personal Income Per Household	33,992	34,460	34,767	35,024	35,297	35,569	36,017	36,323	31,813	33,288	34,640	36,171	37,903
% Change -- Year Ago	3.5	3.6	4.3	2.7	3.8	3.2	3.6	3.7	5.2	4.6	4.1	4.4	4.8
Employment (millions) (civilian:household basis)	115.5	116.2	116.5	116.9	117.2	117.6	118.0	118.3	113.5	115.5	117.0	118.5	119.6
% Change	1.1	2.4	1.2	1.2	1.3	1.2	1.3	1.2	1.8	1.7	1.3	1.2	1.0
Unemployment Rate (%) (civilian)	7.2	7.0	7.0	7.0	7.0	6.9	6.9	7.0	7.5	7.2	7.0	7.0	6.8
Consumer Prices (CPI)	2.3	4.1	1.2	2.1	2.7	2.9	3.3	3.5	4.3	3.5	2.5	3.2	4.0
GNP Deflator	2.9	3.3	3.8	1.7	1.9	2.3	2.6	2.8	4.1	3.3	2.8	2.5	3.3
Personal Cons. Inflation	2.2	4.4	1.4	2.1	2.6	2.8	3.2	3.4	4.1	3.2	2.6	3.1	3.8
Residential Construction	1.1	5.7	3.1	2.2	2.2	2.6	3.2	3.3	4.2	1.9	2.9	3.0	4.2
Nonresidential Const. Inflation	1.2	0.8	1.8	2.1	2.6	3.1	3.9	4.0	0.5	1.4	1.7	3.5	4.0
Producer Price Inflation	-0.8	4.7	-3.6	0.7	2.1	2.9	4.2	4.2	2.1	0.9	0.5	3.5	5.2
Before Tax Corporate Profit	228.6	239.8	227.9	243.3	251.5	259.2	266.6	277.1	237.6	226.8	245.5	278.6	305.4
Corporate Tax Liability	87.5	90.3	84.6	91.6	95.0	98.3	101.4	106.1	93.6	85.9	92.4	106.6	117.8
After Tax Profits	141.1	149.5	143.3	151.7	156.5	160.9	165.2	171.0	144.0	140.9	153.1	172.0	187.6
Inventory Valuation Adjustment	4.7	-10.1	9.5	-8.5	-13.2	-13.9	-16.9	-17.8	-5.4	-0.6	-6.5	-18.9	-26.6
Capital Consumption Allowance	75.9	79.4	85.2	91.3	97.0	102.4	107.4	112.3	41.0	70.9	94.0	114.9	133.7
Federal Tax Receipts (NIPA)	790.7	806.2	811.6	825.6	837.4	849.0	859.6	872.4	725.1	785.4	830.9	876.9	926.7
% of GNP	19.7	19.9	19.7	19.8	19.8	19.8	19.8	19.8	19.2	19.7	19.8	19.7	19.6
Federal Expenditures (NIPA)	992.0	1030.4	1022.1	1010.5	1011.5	1016.3	1032.0	1039.3	898.0	984.7	1015.1	1043.6	1083.0
% of GNP	24.7	25.4	24.8	24.2	23.9	23.7	23.7	23.5	23.8	24.7	24.2	23.5	22.9
Deficit (NIPA)	-201.3	-224.2	-210.5	-184.9	-174.1	-167.3	-172.4	-166.9	-172.9	-199.3	-184.2	-166.7	-156.3
% of GNP	5.0	5.5	5.1	4.4	4.1	3.9	4.0	3.8	4.6	5.0	4.4	3.8	3.3
% of Net Domestic Savings	67.7	72.7	64.0	58.5	55.0	52.0	51.6	49.0	49.2	58.9	54.2	48.2	48.5

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

TABLE 2

APRIL 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales	4,377	4,542	4,559	4,758	4,808	4,772	4,798	4,798	3,933	4,255	4,724	4,764	4,661
(single-family resales and completions)													
Percent **Change** -- **Year Ago**	17.2	18.6	13.3	16.6	9.9	5.1	5.3	0.9	4.9	8.2	11.0	0.9	-2.1
Existing Single-Family Sales (1000's)	3,360	3,500	3,390	3,579	3,618	3,581	3,615	3,632	2,866	3,215	3,542	3,602	3,518
Percent **Change** -- Year Ago	21.6	24.4	14.7	17.6	7.7	2.3	6.6	1.5	5.5	12.2	10.1	1.7	-2.3
Dollar Volume (billions)	310.5	318	337.9	368.3	384.3	366.5	392.5	407.5	247.1	290.9	384.3	403.5	425.5
Existing Home Prices - **Median** ($1000's)	76.6	75.0	77.4	79.0	80.5	78.7	81.6	83.3	72.4	75.1	78.9	83.2	87.4
Percent Change Year - Ago	4.6	4.2	4.9	5.0	5.1	5.0	5.4	5.5	3.6	4.3	5.1	5.4	5.0
Monthly Mortgage Payment (P&I, 80% 30 yr.)	614	562	523	498	484	462	476	483	665	611	492	476	497
Percent of **Median Family Income**	28.2	25.5	23.5	22.2	21.4	20.3	20.6	20.8	32.0	28.4	21.9	20.4	20.4
Housing Starts	1,687	1,773	1,900	1,928	1,955	1,963	1,943	1,905	1,763	1,741	1,936	1,895	1,816
% **Change**	-12.0	5.1	7.2	1.5	1.4	0.4	-1.0	-1.9	3.4	-1.2	11.2	-2.1	-4.2
Single-Family Units	1,048	1,074	1,204	1,215	1,226	1,228	1,219	1,202	1,099	1,072	1,218	1,198	1,178
Percent Change	-7.4	2.5	12.2	0.9	1.0	0.1	-0.7	-1.4	3.3	-2.5	13.6	-1.7	-1.6
Multi-Family Units	639	699	695	713	728	734	723	703	663	668	718	697	637
2-4 Family Units	89	79	81	85	87	88	86	84	121	93	85	83	76
% Change	-41.2	-10.8	2.1	5.2	2.2	0.8	-1.5	-2.9	7.0	-23.4	-8.0	-2.3	-8.6
5+ **Family Units**	550	619	614	628	641	646	636	619	541	575	632	613	560
% Change	-14.5	12.7	-0.9	2.3	2.1	0.8	-1.5	-2.8	2.8	6.2	9.9	-3.0	-8.6
Mobile Homes Shipped	284.7	287.7	304.2	306.0	307.9	308.5	308.0	306.3	294.8	282.9	306.7	306.0	307.0
New Single-Family Home Sales (1000's)	711	692	712	723	756	747	748	756	636.8	687.5	734.5	747.3	737.3
Percent **Change** -- Year Ago	1.8	6.5	7.2	10.6	6.3	7.9	5.1	4.6	6.1	8.0	6.8	1.7	-1.3
New Home Prices -- **Median** ($1000's)	82.8	87.1	88.3	89.8	91.3	92.5	93.2	94.5	80.0	84.2	90.5	95.3	101.2
Percent Change -- Year Ago	1.8	8.5	6.5	6.9	10.2	6.2	5.5	5.2	6.0	5.2	7.5	5.3	5.2
New Home Prices--Mean ($1000's,Quality Adjusted)	104.3	106.4	102.0	105.1	105.9	109.1	104.6	108.1	96.8	104.0	105.5	108.6	113.3
Percent Change -- Year Ago	7.3	7.5	0.8	1.0	1.5	2.5	2.5	2.8	6.6	7.4	1.4	2.9	4.3
NAR Affordability Index	90.8	99.3	106.2	110.3	112.4	116.4	120.9	120.0	89.1	95.5	111.3	121.5	122.4
Mortgage Debt Outstanding (**$** billions)	2,224	2,386	2,334	2,398	2,466	2,535	2,603	2,670	1,948	2,202	2,434	2,703	2,966
Housing Inventory (millions)	95.4	95.8	96.5	96.8	97.3	97.8	98.3	98.8	93.4	95.2	97.0	99.0	100.9
Rental Vacancy Rate(%)	2.8	6.7	6.7	6.8	6.9	6.8	6.8	6.8	5.8	6.5	6.8	6.8	6.7
Office Vacancy Rate (%)<1>	16.2	16.5	16.6	16.8	16.8	16.9	17.0	16.8	13.9	16.0	16.8	16.8	16.4
Industrial Vacancy Rate (%) <1>	4.8	4.9	4.9	4.8	4.6	4.5	4.3	4.3	4.7	4.7	4.7	4.3	4.0
New Commercial Building Construction (% Ch)	59.8	61.6	12.8	5.5	7.8	-15.7	-11.0	-17.1	47.8	60.0	2.6	-9.9	2.5
New Industrial Building Construction (% Ch)	15.4	16.3	-4.9	5.1	8.0	3.5	5.4	1.5	13.7	15.8	2.9	3.4	10.0
FINANCIAL **MARKETS**													
Money Supply (M1)(% change)	15.3	11.0	7.1	7.7	8.0	7.4	6.2	5.3	7.0	9.1	9.3	6.4	5.6
Velocity of M1 (% change)	-8.2	6.1	-0.8	2.6	-2.3	-1.4	-0.2	0.7	3.7	-3.1	-3.7	-0.7	0.7
Value of the U.S. Dollar (Trade-Weighted Index)	139.2	128.2	119.0	113.0	111.9	110.7	109.6	108.5	138.3	143.2	113.6	107.7	103.9
Percent Change	-23.9	-28.1	-25.8	-18.7	-4.0	-4.0	-4.0	-4.0	10.4	3.5	-20.7	-5.2	-3.6
Flow of Funds (NIA Basis)													
(Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	682	697	728	722	729	741	762	778	693	695	730	783	842
Personal Saving	103	115	122	114	110	107	114	113	173	129	113	112	110
Savings Rate	3.7	4.0	4.2	3.9	3.7	3.6	3.8	3.7	6.5	4.6	3.9	3.7	3.4
Gross Business Savings	579	582	606	608	619	634	648	665	521	566	617	671	733
Federal Deficit	201	-224	-211	185	-174	-167	172	167	173	-199	-184	-167	-156
State & Local	57	59	55	56.	56	56	57	57	64	59	56	56	48
Net Foreign Investment	126	-153	-152	136	-139	-140	-142	-142	91	-115	-142	-141	-132
Uses (total:gross investment)	666	681	709	731	751	771	788	808	674	669	741	810	865
Nonresidential Investment	474	487	491	497	503	509	515	521	430	472	500	523	547
Structures	166	169	170	171	174	176	178	180	149	166	173	181	188
Equipment	308	318	321	325	329	333	337	340	282	306	327	342	360
Residential Investment	173	176	182	189	192	194	194	194	168	171	189	193	188
Inventory Investment	-2	-6	9	14	19	25	28	35	63	6	17	32	33
Selected Interest Rates (%)													
Mortgage Rates													
30-year **Fixed Rate Mortgage**<2>	12.1	11.3	10.2	9.5	9.0	8.8	8.8	8.7	13.8	12.2	9.4	8.6	8.4
Real **Mortgage** Rate	9.2	8.0	6.4	7.8	7.1	6.5	6.2	5.9	9.7	8.9	6.6	6.1	5.1
1-year **ARM (without buydown)**	9.6	9.5	9.4	9.2	8.8	8.7	8.6	8.1	12.6	10.1	9.0	8.2	7.9
Real **Mortgage Rate**	6.7	6.2	5.6	7.5	6.9	6.4	6.0	5.3	8.5	6.8	6.2	5.7	4.6
Corporate AAA Bond Rate	11.0	10.6	9.6	8.6	8.2	8.2	7.9	7.7	12.7	11.4	8.6	7.7	7.6
Government Bond Rate	10.7	10.2	8.4	7.6	7.5	7.5	7.3	7.1	12.5	11.0	7.9	7.1	7.0
Real Government Bond Rate	7.8	6.9	4.6	5.9	5.6	5.2	4.7	4.3	8.4	7.7	5.1	4.6	3.7
Federal Funds Rate	7.9	8.1	7.9	7.4	6.9	6.8	6.7	6.5	10.2	8.1	7.3	6.3	6.0
3-month T-Bill Rate	7.1	7.2	6.9	6.4	6.1	6.0	6.0	5.9	9.5	7.5	6.3	5.8	5.7
Real 3-month T-Bill Rate	4.2	3.9	3.1	4.7	4.2	3.7	3.4	3.1	5.4	4.2	3.5	3.3	2.4
1 Year T-Bill Rate	7.9	7.8	7.7	7.5	7.1	7.0	6.9	6.4	10.9	8.4	7.3	6.5	6.2
Real 1-Year T-Bill Rate	5.0	4.5	3.9	5.8	5.2	4.7	4.3	3.6	6.8	5.1	4.5	4.0	2.9
Prime Rate	9.5	9.5	9.4	8.9	8.6	8.6	8.5	8.4	12.0	9.9	8.9	8.2	7.8
Discount Rate	7.5	7.5	7.4	6.9	6.6	6.6	6.2	6.1	8.8	7.7	6.8	6.0	5.9

<1> **Historical Data courtesy of Coldwell Banker.**
<2> **FHA secondary mortgage market** rate.

Source: Forecast produced using **Laurence H. Meyer & Associates'** model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

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Outlook for the Economy and Real Estate

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Outlook for the Economy and Real Estate

First Quarter Growth Rate Up Sharply

The Commerce Department's preliminary estimate of the growth of real or inflation-adjusted Gross National Product (GNP) for the first quarter is 3.2 percent, up sharply from the 0.7 percent growth rate of the final quarter of 1985 and significantly higher than our April forecast of 2.5 percent. The higher than anticipated growth rate was due primarily to stronger consumer spending and inventory building combined with a decline in the merchandise trade balance. Despite this resurgence in the overall growth rate, the underlying data suggests that the economy remains sluggish and that overall growth should weaken during this second quarter. Here are the first quarter highlights:

	Contribution to First Quarter Growth Rate (Percentage Points)
1) Consumption expenditures were up 4.3 percent in real terms compared to an increase of just 0.1 percent during the previous quarter. At the same time the personal saving rate increased to 4.3 percent from 4.0 percent. However, the increases in consumer spending were for nondurable goods and services. Purchases of big ticket durable goods such as automobiles, furniture, and appliances declined.	2.7
2) As lower mortgage interest rates have stimulated housing construction, residential fixed investment increased 9.7 percent in real terms compared to a 5.7 percent increase during the previous quarter.	0.5
3) In response to the decline in the value of the dollar and falling oil prices, exports rose a strong 11.9 percent while imports actually declined. Thus, the merchandise trade balance declined, boosting domestic economic growth.	1.7
4) Despite sharp declines in interest rates, business investment in new plant and equipment declined 13.6 percent in real terms during the first quarter. While the sharp cutbacks in capital spending in the oil industry have exacerbated this problem, business capital spending in general is expected to be weak this year due to declining capacity utilization, particularly in durable goods manufacturing industries.	-1.9
5) Spending restraint by the federal government has offset modest increases by state and local governments to result in a 15 percent decline in public sector purchases of goods and services.	-3.3
6) Inventory investment increased by $32 billion following a decrease of $4.5 billion during the fourth quarter of 1985. Farm inventories increased by $24 billion due to declines in purchases by the Commodity Credit Corporation. Nonfarm inventories increased by about $8 billion. The nonfarm inventory build-up was concentrated in the automobile industry where inventories have risen from 2.3 months supply in January to 3.1 months supply in March.	3.5
TOTAL	3.2

Due to lower food and energy prices, inflation, as measured by the GNP fixed-weight price index, slowed to an annual rate of 2.2 percent during the first quarter, down sharply from the 3.9 percent annual rate of price increase of the final quarter of 1985. Payroll employment growth increased by about 100,000 fewer jobs than during the previous quarter as industrial production declined in response to rising inventories. Declining production levels were very evident in the domestic automobile industry where production declined from a 9.7 million unit annual rate in January to a 7.5 million annual rate in March. Consequently, the unemployment rate rose slightly over the quarter to 7.1 percent from 7.0 percent during the previous quarter.

Weak Second Quarter Expected, Followed by Modest Rebound

At this point it looks as though the economy will weaken during this second quarter, with growth of real GNP falling to about 2 percent. Industrial production, particularly for consumer durables, is likely to decline over the quarter as businesses deplete the unwanted inventory buildup of the past six months. Thus, while consumer spending, residential investment, and net exports should register healthy increases, inventory investment should be negative over the quarter and drag down the overall growth rate.

Once this inventory correction is completed, the positive influences of lower oil prices, lower interest rates, and the reduced value of the dollar should combine to produce a modest rebound of the economy. Real growth rates should return to the 3 to 3-1/2 percent range during the second half of this year and the first quarter of 1987. Overall growth of real GNP for 1986 should be about 2.4 percent compared to 2.2 percent in 1985, increasing to about 2.8 percent in 1987. The underlying trends producing this type of growth path are as follows:

1) As economic expansions mature the overall growth rate subsides, leading to slower growth of household income. This, combined with increasing household debt burdens and declining personal savings rates, leads to slower rates of increase of consumer spending which represents about 65 percent of GNP. This typical trend is evident in the current expansion, which is now in its fourth year, although it is being interrupted by the decline in oil prices which directly increases consumers' purchasing power through lower prices for gasoline and other oil-based products and by the increases in household net worth resulting from strong stock and bond rallies. Another factor contributing to a resurgence of consumer spending is an awareness that the decline in the dollar is likely to increase the prices of many popular products in the near future. However, by the second quarter of 1987 the underlying trend of a mature expansion should reassert itself.

2) While housing starts are likely to remain in the 1.9 to 2.0 million range for the remainder of the year, the fact that starts will be stable rather than increasing means that the contribution of residential investment to economic growth will likely decline over the remainder of this year. In 1987, as starts taper off, the contribution of residential investment should become negative.

3) Business investment in new plant and equipment is likely to remain weak over the course of 1986, particularly for structures, due to low capacity utilization rates and high office vacancy rates. A recent survey by the Department of Commerce revealed that businesses plan to increase investment spending this year just 1 percent compared to actual increases of 7.5 percent in 1985 and 15 percent in 1986. In 1987 it should start to pick up as the decline in the dollar provides needed stimulus to the domestic manufacturing sector.

4) The fall of the dollar relative to the currencies of Japan and Western Europe should provide a gradually improving trade balance over the entire forecast horizon, boosting economic growth. However, given the fact that foreign trade is a relatively small component of GNP this stimulus to growth will only partially offset weakness in other sectors.

5) Given the spending restraint imposed by the need for deficit reduction, government spending for goods and services is likely to decline, actually retarding overall economic growth. This forecast assumes that the second round (FY 1987) of Gramm-Rudman-Hollings spending cuts are made, reducing the federal deficit to about $155 billion in 1987.

6) With relatively modest economic growth employment growth should just keep pace with growth of the labor force, causing the unemployment rate to remain fairly constant around 7 percent.

7) The beneficial impact of lower oil prices on inflation will subside, resulting in some acceleration of inflation as the decline of the dollar boosts import prices and the more rapid rate of price increase in the service sector reasserts itself. The overall increase of the Consumer Price Index should decline to about 2.5 percent in 1986 and then return to 3 percent or higher in 1987.

Monetary Policy and Interest Rates

Interest rates continued to decline during the first two-thirds of the month of April culminating in another cut in the FED's discount rate from 7 percent to 6-1/2 percent on April 18. The yield on 30-year Treasury bonds declined from about 7.7 percent to about 7.2 percent over this three week period as the bond rally was fueled by declining oil prices, evidence of a sluggish economy, and widespread anticipation of additional easing of monetary policy by the FED. The yield on 3-month Treasury bills also declined sharply, from about 6.3 percent to 5.8 percent, while most major banks reduced their prime rate from 9 percent to 8-1/2 percent.

However, over the three days of April 22, 23, and 24, bond prices tumbled and yields on 30-year Treasury bonds rose about one-half percentage point in response to a sharp decline in the value of the dollar relative to the Japanese yen. Bond market participants feared that with the decline of the dollar, Japanese investors would reduce their purchases of U.S. government debt at upcoming auctions, contributing to a general increase in interest rates. During the last week of April these fears subsided as the dollar stabilized, leading to some modest declines in interest rates. However, over the course of the month both long-term and short-term rates were down only about one-quarter of a percentage point.

While the declines are likely to be much more gradual, we continue to expect further reductions in interest rates over the remainder of this year and into 1987. The forces propelling this decline are the expectations of low inflation, relatively modest economic growth, the decline in the deficit due to Gramm-Rudman-Hollings, and the commitment of both the Treasury and the FED to reduce interest rates worldwide through coordinated policy actions with the governments of Western Europe and Japan. Over the remainder of this year the 30-year Treasury bond yield should decline from the current level of about 7-1/2 percent to 7 percent while the yield on 3-month Treasury bills should decline from the current 6.1 percent to about 5-1/2 percent. Rates on 30-year fixed rate mortgages, currently in the 9-1/2 to 10 percent range should decline to about 9 percent.

Housing Markets

Housing markets continue to respond favorably to the lowest mortgage interest rates since 1978. In March existing single-family homes were sold at a seasonally adjusted annual rate of 3.23 million units, down a slight 1.2 percent from the February pace but up 7.7 percent over a year ago. Total private housing starts were at a 1.95 million unit pace in March, also down slightly from the February pace but up over 5 percent over March of 1986. Single-family starts were actually up slightly while multifamily starts were down 7 percent, continuing their erratic path of the past year. Sales of new single-family homes (those purchased after construction has started) rose 27 percent in March to a seasonally adjusted annual rate of 903,000. Inventories of unsold new homes dropped sharply to just 4.6 months supply, supporting the view that starts should remain strong for at least the remainder of this year. For all of 1986 we anticipate about 3.4 to 3.5 million existing home sales and about 1.95 million housing starts. Affordability conditions should remain favorable in 1987, keeping resales at the 3.5 million unit level. However, housing starts should taper off to about 1.9 million units, with most of the falloff occurring in the multifamily category where rental vacancy rates are relatively high.

The increase in housing sales has brought with it faster rates of home price appreciation. Over the past few years home prices have been rising at roughly the overall rate of inflation. Currently, however, while overall inflation is declining, home price appreciation is picking up. In March the median price of existing homes sold was $80,000, up 7.2 percent over a year ago. The average price of new homes sold in March was up 9.4 percent over a year ago. In fact, the NAR Affordability Index dropped slightly in March as the increase in the median home price more than offset the increase in family income and the decline in mortgage interest rates. For all of 1986 prices of existing single-family homes should rise about 6 percent compared to 4 percent in 1985.

Commercial and Industrial Construction

Despite the fact that mortgage interest rates have declined to their lowest levels since 1978, the outlook for construction of new commercial and industrial structures during 1986 is for generally lower levels of activity, particularly for office buildings. The unprecedented office building boom of the last several years appears to have peaked in mid-1985. With the nationwide average office vacancy rate at about 17 percent, a major market correction is in process. Contracts for new office structures, which reached 330 million square feet in 1985, should decline about 30 percent in 1986 to about 230 million square feet. Construction should further decline in 1987 with little or no improvement until the end of this decade by which time growth of white-collar employment should have absorbed the current oversupply.

In response to strong residential building in both 1985 and 1986, demand for retail structures such as stores and warehouses should remain strong. For all of 1986 construction of about 575 million square feet of such structures should be started, down a modest 2 percent from the 1985 level.

Construction of new industrial buildings should also decline modestly this year to about 140 million square feet, down about 6 percent from the 1985 level. This level of new construction is sluggish due to an overall industrial capacity utilization rate that has hovered at 80 percent for the past few years. However, this market should improve over the remainder of the decade as the manufacturing sector of our economy is likely to be a major beneficiary of the reduced value of the dollar.

Table 1

Commercial and Industrial Building Contracts

Year	Stores and Other Commercial		Office Buildings		Industrial Buildings	
	millions of sq ft	percent change	millions of sq ft	percent change	millions of sq ft	percent change
1981	337	-11%	325	+15%	187	-13%
1982	245	-27%	261	-20%	118	-37%
1983	362	+48%	281	+ 8%	107	-37%
1984	478	+32%	318	+13%	144	+33%
1985	585	+22%	330	+ 4%	149	+ 3%
1986^{f}	575	- 2%	230	-30%	140	- 6%

f: forecast

Source: Historical Data: DRI, Review of the U.S. Economy, April 1986.
Forecasts: NATIONAL ASSOCIATION OF REALTORS®

TABLE 2

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,059	4,117	4,163	4,220	4,280	4,345	4,402	4,464	3,775	3,989	4,195	4,434	4,710
% Change	4.3	5.8	4.5	5.6	5.9	6.2	5.3	5.7	11.0	5.7	5.2	5.7	6.2
% Change (w/out inflation)	0.7	3.2	2.0	2.9	3.5	3.2	2.1	2.5	6.6	2.2	2.4	2.8	2.8
Consumption	0.1	4.3	2.4	3.2	3.1	2.4	0.5	0.7	4.4	3.3	2.9	1.9	1.7
Durables	-13.3	-1.5	1.6	4.8	4.9	2.8	-3.4	-0.2	12.4	8.4	1.2	1.5	2.5
Nondurables	0.6	7.7	2.5	2.9	2.8	2.3	1.2	0.9	3.4	2.3	3.4	2.0	1.6
Services	4.4	3.4	2.6	2.9	2.8	2.3	1.2	0.9	3.0	2.5	2.9	2.0	1.6
Residential Investment	5.7	9.7	13.6	1.0	0.7	-0.3	-1.3	-1.7	13.2	1.7	7.6	0.4	-0.6
Nonresidential Investment	11.3	-13.6	8.3	4.3	6.8	4.7	2.4	4.0	19.5	9.7	1.8	4.6	4.0
Structures	7.2	-5.1	0.4	1.3	4.1	4.7	3.3	4.2	14.7	11.4	1.0	3.5	3.9
Equipment	13.5	-17.8	12.9	5.9	8.2	4.8	1.9	3.9	22.2	8.8	2.3	5.2	4.0
Exports	6.6	11.9	5.9	6.5	6.9	7.4	7.6	7.9	6.2	-3.0	5.0	7.3	8.1
Imports	24.5	-3.6	2.1	1.9	2.2	1.2	-0.2	-1.4	22.8	2.7	6.6	0.7	-0.2
Government Purchases	9.2	-15.1	-3.0	-1.4	0.6	0.7	0.4	0.4	4.3	6.0	-0.8	0.1	0.3
Contribution to GNP Growth													
Consumption	0.1	2.7	1.6	2.1	2.0	1.5	0.3	0.5	2.2	1.9	2.1	0.6	1.6
Residential Investment	0.3	0.5	0.6	0.1	0.0	0.0	-0.1	-0.1	0.2	0.3	0.3	-0.1	0.0
Nonresidential Investment	1.4	-1.9	1.1	0.6	0.9	0.6	0.3	0.5	1.9	0.8	0.1	0.4	0.6
Structures	0.3	-0.2	0.0	0.1	0.2	0.2	0.2	0.2	0.6	0.4	0.0	0.2	0.2
Equipment	1.1	-1.7	1.0	0.5	0.7	0.4	0.2	0.3	1.3	0.5	0.1	0.3	0.4
Inventory Change ($ billions)	-0.5	3.6	-0.9	0.1	0.1	0.3	0.6	0.5	0.4	-1.2	0.7	0.5	0.1
Net Exports	-2.3	1.7	0.3	0.4	0.4	0.6	0.8	1.0	-1.5	-1.2	0.7	0.9	0.8
Government Purchases	1.8	-3.3	-0.6	-0.3	-0.1	0.1	0.1	0.1	1.5	1.5	-1.0	0.1	0.0
Mfg. Capacity Utilization Rate	80.1	80.0	79.3	79.5	79.9	80.2	80.1	80.3	80.8	80.3	79.6	80.2	81.4
Domestic Auto Sales (millions)	7.0	7.9	7.6	7.6	7.6	7.7	7.2	6.8	8.0	8.3	7.7	7.1	6.7
Personal Income Per Household	40,616	41,058	41,357	41,661	41,983	42,369	42,714	43,082	38,175	40,029	41,508	42,914	44,712
Percent Change	4.5	3.9	3.4	3.5	3.4	3.2	3.3	3.4	10.4	4.9	3.7	3.4	4.2
Personal Taxes Per Household	6,156	6,088	6,158	6,229	6,303	6,279	6,340	6,405	5,420	5,987	6,194	6,392	6,664
Percent Change	1.3	-1.1	1.2	1.2	2.4	3.1	3.0	2.8	12.2	10.5	3.4	3.2	4.3
Percent of Personal Income	15.2	14.8	14.9	15.0	15.0	14.8	14.8	14.9	14.2	15.0	14.9	14.9	14.9
Disposable Personal Income Per Household	34,460	34,970	35,199	35,431	35,681	36,090	36,374	36,677	32,755	34,042	35,314	36,523	38,048
Percent Change	3.7	4.7	2.4	3.7	3.5	3.2	3.3	3.5	10.7	3.9	3.7	3.4	4.2
Employment (millions) (civilian:household basis)	116.2	117.0	117.4	117.8	118.1	118.5	118.9	119.2	113.5	115.5	117.6	119.0	120.3
% Change	2.4	3.0	1.2	1.3	1.2	1.3	1.3	1.2	1.8	1.7	1.8	1.2	1.1
Unemployment Rate (%) (civilian)	7.0	7.1	7.1	7.1	7.0	7.0	7.0	7.0	7.5	7.2	7.1	7.0	6.7
Consumer Prices (CPI)	4.4	2.0	1.7	1.8	1.7	4.0	4.1	4.1	4.3	3.5	2.5	3.2	3.7
GNP Deflator	3.3	2.5	2.6	2.6	2.2	2.9	3.1	3.1	4.1	3.3	2.8	2.8	3.3
Personal Cons. Inflation	4.4	1.1	2.0	1.9	1.6	3.8	3.9	3.9	4.1	3.2	2.3	3.1	3.5
Residential Construction	5.7	3.3	3.2	3.9	3.2	3.0	3.3	3.6	4.2	1.9	3.4	3.4	4.2
Nonresidential Const. Inflation	0.8	4.0	3.4	3.9	3.9	3.2	3.6	3.8	0.5	1.4	2.7	3.6	4.3
Producer Price Inflation	4.7	-5.7	-0.5	0.8	1.4	3.8	3.9	4.2	2.1	0.9	-0.5	2.8	4.5
Before-Tax Corporate Profits	239.8	216.5	223.9	238.0	247.1	263.0	268.2	277.5	237.6	226.8	231.3	273.5	312.9
Corporate Tax Liability	90.3	81.5	84.3	90.3	94.0	101.3	103.6	107.8	93.6	85.9	87.5	106.0	123.1
After-Tax Profits	149.5	135.0	139.6	147.7	153.1	161.7	164.6	169.7	144.0	140.9	143.8	167.5	189.8
Inventory Valuation Adjustment	-10.1	14.2	1.9	-4.0	-5.0	-15.0	-15.7	-18.2	-5.4	-0.6	1.8	-17.3	-21.7
Capital Consumption Allowance	79.4	81.7	84.3	88.4	92.7	97.5	102.1	106.5	41.0	70.9	86.8	104.2	105.8
Federal Tax Receipts (NIPA)	806.2	805.3	814.9	827.5	838.7	851.4	860.7	872.1	725.1	785.4	821.8	868.3	922.4
% of GNP	19.9	19.6	19.6	19.6	19.6	19.6	19.6	19.5	19.2	19.7	19.6	19.6	19.6
Federal Expenditures (NIPA)	1030.4	1008.6	998.0	998.8	1003.8	1010.4	1017.5	1026.0	898.0	984.7	1002.3	1022.1	1059.9
% of GNP	25.4	24.5	24.0	23.7	23.5	23.3	23.1	23.0	23.8	24.7	23.9	23.1	22.5
Deficit(NIPA)	-224.2	-203.3	-183.1	-171.2	-165.1	-159.0	-156.7	-153.9	-172.9	-199.3	-180.7	-153.8	-137.6
% of GNP	-5.5	-4.9	-4.4	-4.1	-3.9	-3.7	-3.6	-3.4	-4.6	-5.0	-4.3	-3.5	-2.9
% of Net Domestic Savings	-72.7	-61.4	-57.5	-54.6	-52.0	-49.8	-48.6	-47.0	-51.1	-63.1	-56.4	-47.3	-39.8

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

TABLE 3

MAY 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,542	4,479	4,573	4,665	4,765	4,725	4,664	4,608	3,933	4,255	4,620	4,641	4,500
Percent Change -- Year Ago	18.6	11.3	12.1	6.6	4.9	5.5	2.0	-1.2	4.9	8.2	8.6	0.4	-3.0
Existing Single-Family Sales (1000's)	3,500	3,266	3,412	3,499	3,589	3,551	3,502	3,452	2,868	3,215	3,442	3,479	3,340
Percent Change -- Year Ago	24.4	10.5	12.1	4.1	2.5	8.7	2.6	-1.3	5.7	12.2	7.0	1.1	-4.0
Dollar Volume (billions)	318.9	308.2	358.2	376.8	374.6	389.1	398.8	403.5	247.1	291.4	354.5	394.5	408.7
Existing Home Prices - Median ($1000's)	75.2	78.2	80.0	81.3	79.7	82.1	84.2	85.6	72.4	75.5	79.8	84.0	88.2
Percent Change -- Year Ago	4.5	5.9	6.0	6.1	6.0	5.1	5.2	5.3	3.6	4.3	5.7	5.3	5.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	564.5	543.0	506.8	502.3	476.7	479.8	488.3	490.8	665.1	612.9	507.2	483.9	493.1
Percent of Median Family Income	25.6	24.3	22.5	22.2	20.3	20.8	21.0	20.9	32.0	28.4	22.5	20.7	20.3
Housing Starts (1000's)	1,773	1,993	1,951	1,941	1,931	1,928	1,906	1,896	1,763	1,741	1,954	1,902	1,870
Percent Change	5.2	12.4	-2.1	-0.5	-0.5	-0.2	-1.1	-0.5	3.4	-1.2	12.2	-2.6	-1.7
Single-Family Units (1000's)	1,074	1,250	1,197	1,202	1,212	1,211	1,198	1,192	1,100	1,073	1,215	1,198	1,196
Percent Change	2.5	16.4	-4.3	0.4	0.9	-0.1	-1.0	-0.5	3.3	-2.5	13.3	-1.4	-0.1
Multi-Family Units	699	743	754	733	719	717	708	704	663	669	739	704	673
2-4 Family Units (1000's)	80	103	105	103	100	100	99	98	122	93	103	98	94
Percent Change	-9.1	29.6	1.5	-1.9	-2.7	-0.3	-1.2	-0.6	7.0	-23.4	10.4	-3.7	-4.4
5+ Family Units (1000's)	620	640	649	636	619	617	610	606	542	576	636	606	580
Percent Change	15.2	3.2	1.4	-1.9	-2.7	-0.3	-1.2	-0.6	2.8	6.2	10.5	-4.7	-4.4
Mobile Homes Shipped (1000's)	288	271	266	269	272	274	274	275	295	283	269	275	281
New Single-Family Home Sales (1000's)	696	782	792	744	742	698	678	670	639	689	765	683	754
Percent Change -- Year Ago	12.8	17.2	16.5	4.6	6.6	-10.7	-14.4	-9.9	1.7	8.1	11.1	-10.7	10.4
New Home Prices - Median ($1000's)	87.1	87.1	88.9	90.5	91.8	92.8	94.2	95.4	80.0	84.2	89.6	94.7	100.3
Percent Change -- Year Ago	8.5	5.1	5.8	9.3	5.4	6.5	6.0	5.4	6.1	5.3	6.4	5.7	5.9
New Home Prices--Mean ($1000's, Quality Adj.)	106.4	104.5	108.1	109.2	110.2	108.0	111.7	112.8	96.8	104.0	108.0	111.6	116.3
Percent Change -- Year Ago	7.5	3.3	3.8	4.7	3.6	3.3	3.4	3.3	6.6	7.4	3.8	3.3	4.2
NAR Affordability Index	99.3	100.5	108.5	110.3	117.1	117.4	116.3	116.7	89.1	95.5	109.1	117.9	120.6
Mortgage Debt Outstanding ($ billions)	2,386	2,334	2,437	2,514	2,593	2,671	2,748	2,824	1,948	2,202	2,470	2,786	3,093
Housing Inventory (millions)	95.8	96.3	96.8	97.3	97.8	98.3	98.8	99.2	93.4	95.2	97	99	100.9
Rental Vacancy Rate(%)	6.7	6.7	6.8	6.9	6.8	6.7	6.8	6.7	5.8	6.5	6.8	6.7	6.4
Office Vacancy Rate (%)<1>	16.5	16.6	17.0	17.4	17.6	17.9	18.0	17.7	13.9	16.0	17.2	17.8	16.9
Industrial Vacancy Rate (%) <1>	4.9	4.9	4.8	4.6	4.5	4.3	4.3	4.2	4.7	4.7	4.7	4.3	4.0
FINANCIAL MARKETS													
Money Supply (M1)(% change)	11.1	7.9	7.4	6.4	5.8	7.1	5.8	5.5	7.0	9.1	9.1	6.2	4.9
Velocity of M1 (% change)	-6.1	-1.9	-2.7	-0.7	0.0	-0.8	-0.5	0.2	3.7	-3.1	-3.7	-0.5	1.3
Value of the U.S. Dollar (Trade-Weighted)	1.282	1.195	1.130	1.119	1.107	1.096	1.085	1.071	1.383	1.432	1.138	1.077	1.057
Percent Change	-28.1	-24.5	-20.0	-4.0	-4.0	-4.0	-4.0	-5.0	10.4	3.5	-20.6	-5.3	-1.8
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	697	718	717	722	735	744	757	772	693	695	723	765	823
Personal Saving	115	124	122	114	110	109	108	108	173	129	118	108	111
Savings Rate	4.0	4.3	4.2	3.9	3.7	3.6	3.5	3.5	6.5	4.6	4.0	3.5	3.5
Gross Business Savings	582	594	594	608	625	635	650	665	521	566	605	657	712
Federal Deficit	-224	-203	-183	-171	-165	-159	-157	-154	-173	-199	-181	-154	-138
State & Local	59	64	60	58	59	60	59	58	64	59	60	59	63
Net Foreign Investment	-153	-130	-131	-127	-123	-116	-119	-120	-91	-118	-128	-118	-107
Uses (total:gross investment)	681	708	718	732	748	763	777	794	674	669	727	786	852
Nonresidential Investment	487	469	479	484	492	497	500	505	430	472	481	503	523
Structures	169	167	167	167	169	171	172	174	149	166	167	173	180
Equipment	318	303	312	316	323	327	328	331	282	306	313	330	343
Residential Investment	176	180	185	186	186	186	186	185	168	171	184	185	184
Inventory Investment ($ billions)	-6	-26	18	19	20	23	28	33	63	6	21	31	41
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage	11.3	10.4	9.5	9.3	9.0	8.8	8.7	8.6	13.8	12.2	9.6	8.7	8.4
Real Mortgage Rate	8.0	7.9	6.9	6.7	6.8	5.9	5.6	5.5	9.7	8.9	6.8	5.9	5.1
1-year ARM (without buydown)	9.5	9.2	8.0	7.9	7.7	7.6	7.4	7.4	12.6	10.1	8.2	7.5	7.6
Real Mortgage Rate	6.2	6.7	5.4	5.3	5.5	4.7	4.3	4.3	8.5	6.8	5.4	4.7	4.3
Corporate AAA Bond Rate	10.6	9.6	8.5	8.4	8.1	7.9	7.6	7.5	12.7	11.4	8.7	7.6	7.3
Government Bond Rate	10.2	8.9	7.3	7.2	7.0	6.8	6.7	6.7	12.5	11.0	7.6	6.7	6.6
Real Government Bond Rate	6.9	6.4	4.7	4.6	4.8	3.9	3.6	3.6	8.4	7.7	4.8	3.9	3.3
Federal Funds Rate	8.1	7.8	7.0	6.6	6.3	6.0	5.8	5.6	10.2	8.1	6.9	5.7	5.8
3-month T-Bill Rate	7.2	7.0	5.9	5.5	5.3	5.2	5.1	5.1	9.5	7.5	5.9	5.1	5.4
Real 3-month T-Bill Rate	3.9	4.5	3.3	2.9	3.1	2.3	2.0	2.0	5.4	4.2	3.1	2.3	2.1
1 Year T-Bill Rate	7.9	7.5	6.3	6.2	6.0	5.9	5.7	5.7	10.9	8.4	6.5	5.7	5.9
Real 1-Year T-Bill Rate	4.6	5.0	3.7	3.6	3.8	3.0	2.6	2.6	5.2	4.0	3.7	3.0	2.6
Prime Rate	9.5	9.4	8.8	8.5	8.3	8.0	7.7	7.4	12.0	9.9	8.8	7.5	7.2
Discount Rate	7.5	7.4	6.7	6.4	6.2	5.8	5.7	5.6	8.8	7.7	6.7	5.7	5.7

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market rate.

Source: Forecast produced using Laurence H. Meyer & Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

Special Supplement:

Where Has the Deficit Gone?

For the past several years federal budget projections have been cause for despair. Federal deficits of $200 billion or more for ". . . as far as the eye can see" were the conventional wisdom. In fact, just last August the Congressional Budget Office (CBO) released its updated baseline which projected a deficit of nearly $300 billion by 1990[1]. This gloomy forecast no doubt contributed to the sense of urgency which lead to the passage of the Balanced Budget and Emergency Deficit Control Act of 1985 or Gramm-Rudman-Hollings (GRH) which requires Congress and the President to adopt budgets with declining deficits and a balanced budget by 1991.

Since then there has been a fundamental change in CBO's deficit projection. In their February "Economic and Budget Outlook, 1987-1991," CBO projects that with no changes in current policies and economic growth of between 3 and 3-1/2 percent per year, the federal deficit will shrink from its current level of $208 billion to $104 billion by 1991. In terms of its burden on the economy the deficit would fall from its current 5 percent of GNP to 1.7 percent in 1991. As shown in Table 4, 60 percent of the downward revision of the deficit projection comes from lower defense outlays, 25 percent comes from lower net interest outlays due to the lower deficit and to lower interest rates, and 22 percent comes from reduced outlays for nondefense discretionary programs. Other assorted policy and economic changes combine to increase the deficit slightly.

Understandably, such a dramatic change in the deficit projections have caused considerable debate, not only over whether or not they are realistic from a purely economic viewpoint but also over the political implications. Some interested parties have argued that the deficit outlook has indeed improved this much, that in fact the CBO baseline is pessimistic given recent favorable economic developments, so that drastic spending cuts and possible tax increases are not required to achieve the GRH deficit target of $144 billion for FY 1987. In contrast, others argue that the CBO baseline is unrealistically optimistic and that Congress and the Administration will have to make some hard decisions regarding spending cuts and possible tax increases to meet the deficit target required by law.

The following is a brief discussion of some of the key issues underlying the debate over the CBO baseline:

1) Economic Assumptions

Deficit projections are extremely sensitive to the overall growth rate of the

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[1] CBO's baseline projection of future federal deficits assumes that no changes are made in current federal spending and taxation policies. The February 1986 baseline accounts for the March 1 GRH sequestration of $11.7 billion but assumes no further GRH spending reductions nor does it include all of the deficit reduction impacts of the Consolidated Budget Reconciliation Act of 1986. Regarding the economy, the baseline combines an economic forecast for 1986 and 1987 with assumptions about the state of the economy for 1988 through 1991 based on average historical experience. The baseline is not intended as a forecast of the deficit, particularly for the out-years, but rather a benchmark against which policy changes can be evaluated.

Table 4

Changes in CBO Baseline Deficit Projections Since August 1985
(By fiscal year, in billions of dollars)

	1986	1987	1988	1989	1990	1991
August 1985 Baseline	212	229	243	264	285	NA
Major Changes:						
Lower Defense Outlays	-9	-26	-48	-71	-96	NA
Lower Net Interest Costs	a/	-7	-16	-31	-51	NA
Lower Nondefense Discretionary Program Outlays	-10	-19	-20	-21	-22	NA
Other Changes	15	5	6	3	4	NA
Total Changes	-4	-48	-78	-120	-165	NA
February 1986 Baseline	208	181	165	144	120	104

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a/Less than $500 million.

NA - Not Available

Source: Congressional Budget Office, "The Economic and Budget Outlook: Fiscal Years 1987-1991", February 1986, page xxi.

economy that is assumed. Faster economic growth tends to reduce the deficit by resulting in larger federal revenues and lower federal outlays for income-support programs such as unemployment compensation and food stamps. In its February publication CBO presented three deficit projections based on three different economic scenarios; high economic growth, baseline economic growth (CBO's estimate of the most likely course for the economy), and low economic growth which assumes a recession in 1987 and 1988. Table 5 presents the assumed growth rates and resulting deficits for each of these scenarios. As can be seen, under the low-growth alternative, by FY 1988 the deficit is $100 billion greater than under the baseline.

Table 5

Alternative Economic and Deficit Projections

	1986	1987	1988	1989	1990	1991
Real GNP[a]						
High Growth	4.0	4.3	4.4	4.6	4.6	4.6
Baseline	3.2	3.1	3.3	3.5	3.5	3.2
Low-Growth	3.0	-0.7	-0.8	5.4	3.4	3.2
Deficit (-) or Surplus						
High Growth	-202	-154	-111	-61	-1	70
Baseline	-208	-181	-165	-144	-120	-104
Low-Growth	-210	-224	-282	-271	-238	-237

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[a] By calendar year; year-over-year changes.

[b] By fiscal year, in billions of dollars.

Source: Congressional Budget Office, "The Economic and Budget Outlook: Fiscal Years 1987-1991", February 1986, page xxiii.

Now it is true that since CBO produced the February baseline there have been some very favorable economic developments. Oil prices and the value of the dollar have fallen dramatically. Due to lowered inflation expectations interest rates have fallen and are now below levels assumed in the CBO baseline. However, despite these favorable developments economic growth remains sluggish. Many private forecasters now predict considerably slower growth of the economy than was assumed in the baseline; in the 2 to 3 percent range for the 1986 to 1988 period and 3 percent as the long-term trend growth rate for the 1989 to 1991 period. Thus, while it is by no means a view held by all private economists, many would argue that CBO is overly optimistic in its baseline economic growth projections.

2) Defense Spending

As shown in Table 4, deficit projections are also extremely sensitive to what is assumed regarding growth of defense spending. The August 1985 CBO baseline assumed that defense spending would increase at 5-1/2 percent per year in real or inflation adjusted terms, consistent with the fiscal 1985 budget resolution. In contrast, the February 1986 CBO baseline assumes no real growth of defense spending, meaning that defense spending will increase only at the rate of inflation. This change reduces defense spending by $250 billion over the 1986 to 1991 period and further reduces federal outlays since with a lower deficit there is a slower accumulation of federal debt and so reduced net interest outlays. While zero real growth of defense spending is consistent with the baseline concept since this is roughly what was approved for the fiscal 1986 budget, it seems unlikely to occur given the strong preference for increased defense spending within the Reagan Administration and among a not-insignificant number of members of Congress.

Table 6 presents the NAR baseline which is based on our forecast for the growth of real GNP, inflation, and interest rates. Two scenarios are presented for the NAR baseline, zero real growth of defense spending and three percent real growth of defense spending. Under the three percent real growth of defense spending scenario the overall growth rate of the economy is somewhat faster which in effect pays for some of the increased defense spending through higher tax revenues.

Note that even with no real growth of defense, the decline in the deficit is about 30 billion less per year. With three percent real growth of defense the deficit would be $40 to $50 billion higher per year. Thus, the amount of deficit reduction required to meet the FY 1987 GRH target of $144 billion is at least $30 billion more than is currently being assumed by Congress. Recent reports that Congress is finding that GRH deficit reduction is not the "bitter pill" once thought is due to the fact that much of the illness has been assumed not to exist.

Table 6

CBO Baseline Deficit Versus NAR
Baseline Deficit with Alternative Real
Growth Rates for Defense Spending

	1986	1987	1988	1989	1990	1991
Gramm-Rudman-Hollings Targets	171	144	108	72	36	0
CBO Baseline	208	181	165	144	120	104
NAR Baseline Real Growth of Defense:						
0%	205	211	191	171	156	133
3%	205	220	205	184	169	150

Source: NATIONAL ASSOCIATION OF REALTORS®

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June 1986

Outlook for the Economy and Real Estate

REALTOR®

Forecasting & Policy
Analysis Division
NATIONAL ASSOCIATION OF REALTORS®
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The Outlook for the Economy and Real Estate

The Commerce Department has revised upward the first quarter growth rate of real or inflation-adjusted Gross National Product (GNP) from 3.2 percent to 3.7 percent. However, the economy is not as robust as these figures suggest as all of this growth is attributable to an accumulation of inventories while final sales of goods and services actually declined. This underlying weakness of the economy is apparent in the economic indicators available thus far which suggest a second quarter real GNP growth rate of about 2 percent. During the second half of 1986 a modest rebound of economic growth is anticipated due to the stimulus to consumer spending and both residential and business investment provided by lower interest rates, lower oil prices, and the decline in the value of the dollar. During the third quarter growth of real GNP should rise to about 3-1/2 percent and should remain in the 3 to 3-1/2 percent range through the first quarter of 1987. For all of 1986 real GNP should increase about 2.5 percent compared to an increase of 2.2 percent in 1985 and 6.6 percent in 1984. During 1987 growth of consumer spending and residential investment should taper off but should be more than offset by more rapid growth of business investment and exports, boosting the overall growth rate to about 3 percent.

The second quarter growth rate of real GNP should be held down to about 2 percent due to a major inventory correction. Production in the current quarter is relatively weak as retailers, wholesalers, and manufacturers deplete the unwanted inventory buildup of the first quarter. New orders for durable goods fell in April for the third consecutive month. Industrial production was up modestly in April due entirely to an increase in automobile production in anticipation of increased sales due to strong financing incentives. Payroll employment increased a modest 149,000 in May compared to an increase of 313,000 in April. In May, payroll employment in goods-producing industries fell by 50,000 while the average workweek also declined, suggesting that industrial production may have actually declined in May. Overall, reduced inventory investment should subtract about 1-1/2 percentage points from the second quarter growth rate. On the other hand final sales should contribute about 3-1/2 percentage points to the second quarter growth rate as growth in consumption spending slows but remains positive, residential investment increases sharply, business investment rebounds from the sharp decline of the first quarter, and the trade balance continues to improve.

This second quarter should be a transition to a modest rebound of economic growth in the second half of 1986 prompted by the decline in interest rates over the past year, the sharp fall in energy prices, and the decline in the dollar relative to key currencies such as the Japanese yen and the West German mark. The decline in interest rates has already boosted housing construction which should provide strong stimulus to the economy over the remainder of this year. Lower rates should also encourage business investment which has otherwise been battered by sharp cutbacks in the domestic energy industry and an overall low capacity utilization rate. Further, the decline in interest rates has increased the value of bond holdings and helped push up stock prices, both of which increase household net worth and so encourage consumer spending. The decline in energy prices has been a major factor in the decline in interest rates and has also increased consumers' disposable income in a manner similar to a tax cut. Finally, the sharp and sustained decline of the dollar since the end of 1985 should put U.S. producers on a much more competitive footing which should translate into an improvement in the balance of trade. In April the merchandise trade deficit recorded a modest $2 billion improvement which should be followed by continued improvement in the months ahead.

It should be emphasized that this rebound is anticipated to be relatively modest in strength and duration and so should not lead to higher interest rates. Growth of real GNP should increase to about 3-1/2 percent in the third quarter and remain in the 3 to 3-1/2 percent range through the first quarter of 1987 before falling back under 3 percent. Three retarding forces are likely to put downward pressure on economic growth during this period:

1) restraint in government spending due to implementation of Gramm-Rudman-Hollings;

2) further cutbacks in domestic automobile production due to sluggish sales and high inventories; and

3) weakness in business investment in new equipment and structures.

The outlook for inflation continues to be dominated by the sharp decline in the price of imported oil that occurred earlier this year. Both the Consumer Price Index (CPI) and the Producer Price Index (PPI) have recorded monthly declines since February. For all of 1986 the CPI is anticipated to rise just 2 percent. However, as the effect of lower oil prices dissipates, underlying inflation in some sectors of the economy should reassert themselves. For example, prices of services, which account for half of consumer spending, have been increasing at an annual rate of about 4 percent due to wage pressures and modest productivity growth. The prices of imported goods and services have also been rising due to the decline of the dollar and should continue to rise at a rate much higher than the overall price level for the next several years. Therefore, inflation should start to increase in the second half of this year with the CPI increasing about 3 percent in 1987 and rising to about 3-1/2 percent in 1988.

The civilian unemployment rate rose to 7.3 percent in May from 7.1 percent in April as sluggish economic growth kept employment growth below the increase in the labor force. In May nonfarm payroll employment increased a modest 149,000, with employment in service-producing industries up by 199,000 and employment in goods producing industries down 50,000. Within the service sector, employment in finance, insurance, and real estate was up by about 350,000 over a year earlier reflecting the healthy state of the housing market. Similarly, employment in construction was up by about 310,000 jobs over a year earlier. Weakness in the manufacturing sector was evidenced by the fourth consecutive monthly decline in employment resulting in over 100,000 fewer jobs than a year ago. The overall unemployment rate should hover in the low seven percent range for at least the next 18 months as the modest rebound of the economy boosts employment just enough to keep the unemployment rate stable.

Monetary Policy and Interest Rates

The bond rally of the first part of the year has come to a halt as the bond market currently suffers from a case of indigestion with accompanying nervousness. After declining to low of 7.1 percent in April, the yield on 30-year U.S. Treasury bonds climbed back to 7.9 percent by the end of May. An increase in the index of leading economic indicators for April of 1.5 percent accentuated fears of a resurgence of economic growth which would preclude further easing by the FED and could cause rates to rise. Also contributing to investor jitters is the sharp decline in the value of the dollar relative to the yen which could curb the Japanese appetite for Treasury securities despite the continuance of a significant spread between U.S. and Japanese interest rates. Therefore, until a clearer picture of the state of the economy and the demand of foreign investors emerges, the tremendous bond rally of the past year is likely to remain on hold.

While future declines in interest rates are likely to be much more gradual than over the past year, further reductions in interest rates over the remainder of this year and into 1987 are expected. Mortgage interest rates should fall back to the 9-1/2 to 10 percent range by the end of 1986. The following underlying forces should contribute to this decline:

- Low Inflation: Due to lower energy and food prices, inflation is expected to slow to 2.0 percent this year from a 3-1/2 percent rate in 1985. While inflation may accelerate modestly in 1987, it is expected to remain in the 3 to 4 percent range through 1988.

- Sluggish Economic Growth: A second half growth spurt is anticipated but only to about 3 percent, not the 4 or 5 percent that some analysts have projected. The current economic expansion is in its fourth year and the consumer, the driving force of the recovery so far, is burdened with debt. If the recovery is to continue, lower interest rates are needed to spur residential and business investment.

- Deficit Reduction: Both houses of Congress have already passed budgets which meet the FY 1987 Gramm-Rudman-Hollings deficit target of $144 billion. While the actual FY 1987 budget deficits will likely come in $10 to $20 billion higher than that, the fact that the deficit is declining is providing a psychological boost to the bond market plus contributing to sluggish economic growth. The lower deficit should also allow the FED to ease monetary policy with less fear of rekindling inflation.

Real Estate Markets

Housing has been the only sector of the economy exhibiting consistent strength in an environment of falling interest rates. The pace of total housing starts remains just under 2 million units and is expected to slow only slightly over the remainder of this year. The existing home market also remains robust as the annual pace of resales increased 11.3 percent from March to April to 3.56 million units--the highest level in 6-1/2 years. Existing home sales are expected to remain strong through 1986 averaging 3.5 million units for the entire year. By 1987, as mortgage interest rates near 9 percent, existing home sales should top 3.6 million units.

The rate of growth of resale activity differs across regions. According to April's existing home sales figures, the Midwest has posted the strongest gain over the past 12 months increasing 38 percent. The Northeast posted the next highest annual gain with a 27 percent increase. In the South resales were up 7 percent over a year ago while in the West they were up 2 percent.

As the demand for housing has strengthened, the rate of increase of home prices has accelerated. In April, the median resale price increased to $81,100--an increase of 8.4 percent over a year ago. For all of 1986 home prices are expected to well outpace inflation, increasing 6 percent over the entire year to a median price of $79,900.

The outlook for nonresidential construction remains mixed. Within commercial investment, construction of retail space should remain strong as increased housing activity spurs demand for nearby stores and warehouses. Office construction, on the other hand, should weaken as high vacancy rates and oversupply dampen investment in this area.

June 1986

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,059	4,121	4,164	4,228	4,285	4,346	4,400	4,456	3,775	3,989	4,200	4,430	4,676
% Change	4.3	6.3	4.3	6.2	5.5	5.8	5.0	5.2	11.0	5.7	5.3	5.5	5.6
% Change (w/out inflation)	0.7	3.7	1.9	3.4	3.2	3.0	2.8	2.5	6.6	2.2	2.5	2.9	2.5
Consumption	0.1	4.2	3.2	2.0	3.5	1.6	1.6	1.7	4.4	3.3	2.9	2.1	1.8
Durables	-13.3	0.2	4.6	-0.7	8.9	-1.5	0.7	1.6	12.4	8.4	1.8	2.0	2.3
Nondurables	0.6	6.9	1.9	3.5	2.3	1.9	1.4	1.5	3.4	2.3	3.1	2.0	1.7
Services	4.4	3.4	3.7	1.6	2.8	2.4	1.9	1.8	3.0	2.5	3.0	2.2	1.8
Residential Investment	5.7	5.3	17.9	7.2	1.[illegible]	-2.5	-3.9	-3.2	13.2	1.7	8.1	0.2	-1.9
Nonresidential Investment	11.3	-13.0	5.2	5.3	6.2	4.2	3.2	3.8	19.5	9.7	1.5	4.4	3.3
Structures	7.2	-11.3	0.2	2.0	4.0	4.1	4.5	4.1	14.7	11.4	-0.7	3.6	3.4
Equipment	13.5	-13.9	8.0	7.0	7.3	4.3	2.5	3.6	22.2	8.8	2.7	4.8	3.2
Exports	6.6	10.6	4.8	6.1	6.9	7.7	7.9	8.1	6.2	-3.0	4.5	7.3	7.2
Imports	24.5	-1.1	-1.8	0.4	1.4	1.0	1.0	-0.9	22.8	2.7	6.3	0.4	-0.6
Government Purchases	9.2	-13.6	-3.6	0.0	0.4	1.2	1.0	0.9	4.3	6.0	-0.3	0.5	0.7
Contribution to GNP Growth													
Consumption	0.1	2.7	2.1	1.3	2.2	1.0	1.0	1.1	2.2	1.9	2.1	1.1	1.2
Residential Investment	0.3	0.3	0.8	0.4	0.1	-0.1	-0.2	-0.2	0.2	0.3	0.4	-0.2	0.0
Nonresidential Investment	1.4	1.8	0.7	0.7	0.8	0.6	0.4	0.5	1.9	0.8	0.1	0.5	0.4
Structures	0.3	-0.6	0.0	0.1	0.2	0.2	0.2	0.2	0.6	0.4	-0.1	0.2	0.1
Equipment	1.1	-1.[illegible]	0.7	0.6	0.6	0.4	0.2	0.3	1.3	0.5	0.1	0.3	0.3
Inventory Change ($ billions)	-0.5	4.5	-1.6	0.5	-0.5	0.7	0.7	0.0	0.4	-1.2	0.7	0.4	-0.1
Net Exports	-2.3	1.2	0.7	0.5	0.5	0.6	0.7	1.0	-1.5	-1.2	0.7	0.8	0.7
Government Purchases	1.8	-2.9	-0.7	0.0	0.1	0.2	0.2	0.2	1.5	1.5	-0.9	0.2	0.1
Mfg. Capacity Utilization Rate	80.1	80.0	79.1	79.5	79.8	80.1	80.3	80.4	80.8	80.3	79.6	80.4	80.9
Domestic Auto Sales	7.0	7.9	7.9	7.5	7.7	7.7	7.4	7.2	8.0	8.3	7.8	7.4	6.8
Personal Income Per Household	40,616	41,065	41,355	41,705	42,073	42,493	42,885	43,259	38,175	40,029	41,543	43,078	44,787
Percent Change -- Year Ago	4.3	3.9	3.6	4.1	3.6	3.5	3.7	3.8	10.4	4.9	3.8	3.7	4.0
Personal Taxes Per Household	6,156	6,090	6,157	6,237	6,318	6,293	6,363	6,428	5,420	5,987	6,200	6,412	6,665
Percent Change -- Year Ago	8.9	-0.5	9.5	3.1	2.6	3.4	3.3	3.1	12.2	10.5	3.5	3.4	4.0
Percent of Personal Income	15.2	14.8	14.9	15.0	15.0	14.8	14.8	14.9	14.2	15.0	14.9	14.9	14.9
Disposable Personal Income Per Household	34,460	34,975	35,198	35,469	35,755	36,200	36,522	36,831	32,755	34,042	35,343	36,666	38,122
Percent Change -- Year Ago	3.5	4.7	2.7	4.3	3.7	3.5	3.7	3.9	8.3	3.9	3.8	3.7	4.0
Employment (millions) (civilian household basis)	108.0	108.8	109.1	109.4	109.8	110.0	110.2	110.6	105.0	107.2	109.3	110.4	112.0
% Change	3.0	2.9	1.2	1.2	1.3	0.7	1.0	1.2	4.1	2.1	1.9	1.1	1.4
Unemployment Rate (%) (civilian)	7.0	7.1	7.0	7.1	7.0	7.1	7.2	7.2	7.5	7.2	7.0	7.1	6.8
Consumer Prices (CPI)	4.4	1.4	-1.7	3.2	2.9	5.0	3.4	3.5	4.3	3.5	2.0	2.9	3.5
GNP Deflator	3.3	2.5	2.4	2.8	2.3	2.7	2.1	2.6	4.1	3.3	2.7	2.5	3.0
Personal Cons. Inflation	4.4	1.1	1.5	2.5	2.4	2.9	3.0	3.1	4.1	3.2	2.3	2.7	3.1
Residential Construction Inflation	5.7	5.6	3.1	3.4	3.1	2.8	2.9	3.2	4.2	1.9	3.8	3.1	3.8
Nonresidential Construction Inflation	0.8	4.0	3.5	3.8	3.0	3.2	3.3	3.6	0.5	1.4	2.7	3.4	4.1
Producer Price Inflation	4.7	-5.7	-0.1	0.5	2.3	3.5	3.5	3.9	2.1	0.9	-0.4	2.8	4.2
Before Tax Corporate Profit	234	218	231	242	253	259	258	262	238	225	236	261	282
Corporate Tax Liability	87.1	78.5	88.1	92.4	97.6	100.2	99.4	100.9	93.6	85.1	89.1	100.9	109
After Tax Profits	147	140	143	149	156	159	159	161	144	140	147	161	173
Inventory Valuation Adjustment	-10.[illegible]	17.3	1.2	-0.9	-10.3	-13.2	-14.0	-16.8	-5.4	-0.6	1.3	-15.8	-20.3
Capital Consumption Allowance	79	79	84	88	93	98	102	107	41	71	86	105	106
Federal Tax Receipts (NIPA)	803.5	802.9	813.9	828.8	840.8	848.2	855.9	865.4	725.1	784.7	821.6	862.3	908.8
% of GNP	19.8	19.5	19.5	19.6	19.6	19.5	19.5	19.4	19.2	19.7	19.6	19.5	19.4
Federal Expenditures (NIPA)	1030.4	1013.4	999.8	1001.8	1009.1	1018.9	1028.7	1039.4	898	984.7	1006	1033.9	1075.3
% of GNP	25.4	24.6	24.0	23.7	23.5	23.4	23.4	23.3	23.8	24.7	24.0	23.3	23.0
Deficit(NIPA)	-226.9	-210.5	185.9	-173.0	168.3	-170.6	172.9	-174.0	-172.9	200.0	-184.4	-171.1	-166.5
% of GNP	5.6	5.1	4.5	4.1	3.9	3.9	3.9	3.9	4.6	5.0	4.4	3.9	3.6
% of Net Domestic Savings	74.4	62.1	58.4	54.0	53.4	51.3	51.6	51.7	51.1	63.5	57.0	51.1	47.9

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

TABLE 3

June 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,542	4,467	4,702	4,780	4,870	4,848	4,812	4,730	3,933	4,255	4,705	4,758	4,529
Percent Change -- Year Ago	18.6	11.0	15.2	9.2	7.2	8.5	2.3	-1.0	5.1	8.2	10.5	1.1	-4.8
Existing Single-Family Sales (1000's)	3,500	3,257	3,495	3,579	3,669	3,675	3,645	3,583	2,866	3,214	3,500	3,601	3,400
Percent Change -- Year Ago	24.4	10.1	14.8	6.5	4.8	12.8	4.3	0.1	5.7	12.1	8.9	2.9	-5.6
Dollar Volume (billions)	318.9	307.3	367.3	384.4	381.9	402.8	417.2	419.5	247.1	291.4	360.2	409.1	416.5
Existing Home Prices - Median ($1000's)	75.2	78.1	80.2	81.3	79.8	82.3	84.6	85.8	72.4	75.5	79.9	84.2	88.4
Percent Change Year - Ago	4.5	5.8	6.2	6.1	6.0	5.4	5.5	5.6	3.0	4.3	6.0	5.5	5.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	564.5	542.6	528.7	525.5	507.1	520.8	524.0	525.9	618.0	609.0	526.0	519.3	515.2
Percent of Median Family Income	26.1	24.8	24.0	23.6	22.6	23.0	22.9	22.8	28.2	26.2	23.7	22.6	21.6
Housing Starts (1000's)	1,773	1,988	1,985	1,975	1,970	1,903	1,860	1,862	1,763	1,741	1,980	1,871	1,807
Percent Change -- Year Ago	10.0	12.9	13.9	17.0	11.1	-4.3	-5.3	-5.7	3.4	-1.2	13.7	-5.5	-3.4
Single-Family Units (1000's)	1,074	1,248	1,244	1,238	1,238	1,210	1,203	1,182	1,100	1,073	1,242	1,193	1,163
Percent Change -- Year Ago	2.5	13.6	16.4	18.1	15.2	-3.1	-3.3	-4.5	3.3	-2.5	15.8	-4.0	-2.4
Multi-Family Units	699	740	741	737	732	693	677	680	663	669	738	879	644
2-4 Family Units (1000's)	80	101	101	101	100	95	93	93	122	93	101	93	88
Percent Change -- Year Ago	-30.7	0.0	-0.6	12.9	25.8	-6.4	-8.6	-7.8	7.0	-23.4	8.5	-8.0	-5.2
5+ Family Units (1000's)	619.7	639	639.5	636.1	631.8	598.3	584.2	586.5	541.9	575.8	636.6	585.8	555.6
Percent Change -- Year Ago	37.6	13.8	11.8	15.7	2.0	-6.4	-8.6	-7.8	2.8	6.2	10.6	-8.0	-5.2
Mobile Homes Shipped (1000's)	288	262	264	266	268	266	268	267	295	283	265	267	271
New Single-Family Home Sales (1000's)	696	789	720	758	764	751	730	705	636.8	688.5	757.8	716.8	689.8
Percent Change -- Year Ago	12.8	18.3	5.9	6.6	9.8	-4.8	1.4	-7.0	1.7	8.4	10.1	-5.3	-3.6
New Home Prices - Median ($1000's)	86.8	88.0	89.9	91.7	93.2	93.3	93.6	93.8	80.0	84.1	90.7	93.7	97.6
Percent Change -- Year Ago	8.1	6.2	7.0	10.7	7.4	6.0	4.1	2.3	6.1	5.2	7.8	3.3	4.2
New Home Prices - Mean ($1000's Quality Adj.)	106.4	104.6	108.1	109.1	110.1	107.9	111.3	112.4	96.8	104.0	108.0	111.3	115.5
Percent Change -- Year Ago	7.5	3.4	3.8	4.6	3.5	3.1	3.0	3.0	6.6	7.4	3.8	3.0	3.8
NAR Affordability Index	99.3	100.6	104.0	105.5	110.3	108.5	108.8	109.4	84.6	90.3	105.1	109.3	113.6
Mortgage Debt Outstanding ($ billions)	2,280	2,309	2,400	2,473	2,547	2,618	2,687	2,757	1,948	2,163	2,433	2,722	3,006
Housing Inventory (millions)	95.8	96.3	96.8	97.3	97.8	98.3	98.8	99.2	93.4	95.2	97.0	99.0	100.9
Rental Vacancy Rate (%)	6.7	6.9	6.8	6.7	6.7	6.6	6.6	6.5	5.8	6.5	6.8	6.6	6.4
Office Vacancy Rate (%) <1>	16.5	16.6	16.8	16.8	16.9	17.0	16.8	16.7	13.9	16.0	16.8	16.8	16.4
Industrial Vacancy Rate (%) <1>	4.9	4.9	4.8	4.6	4.5	4.3	4.3	4.2	4.7	4.7	4.7	4.3	4.0
FINANCIAL MARKETS													
Money Supply (M1)(% change)	11.1	7.9	12.2	7.5	5.7	5.3	4.6	5.4	7.0	9.1	10.2	5.9	5.0
Velocity of M1 (% change)	-6.1	-1.5	-7.0	-1.2	-0.2	0.5	0.4	-0.2	3.7	-3.1	-4.5	-0.5	0.5
Value of the U.S. Dollar (Trade-Weighted)	128.2	119.5	114.0	112.8	111.7	110.6	109.4	108.0	138.3	143.2	114.5	108.7	106.7
Percent Change	-28.1	-24.5	-17.1	-4.0	-4.0	-4.0	-4.0	-5.0	10.4	3.5	-20.1	-5.1	-1.8
Flow of Funds (NIA Basis) (Billions of dollars, saar)													
Sources: (Total: Gross Savings)													
Private Saving	694	726	718	732	732	758	770	781	693	694	727	775	827
Personal Saving	115	126	120	119	110	124	125	125	173	129	119	123	131
Savings Rate	4.0	4.4	4.1	4.0	3.7	4.1	4.1	4.0	6.5	4.6	4.1	4.0	4.1
Gross Business Savings	579	600	598	613	622	634	645	657	521	565	608	651	695
Federal Deficit	-227	-211	-186	-173	-168	-171	-173	-174	-173	-200	-184	171	-167
State & Local	59	65	59	56	58	58	58	58	64	59	59	58	59
Net Foreign Investment	153	134	136	130	125	122	123	125	91	115	131	123	113
Uses (Total: Gross Investment)	681	715	719	739	748	768	778	787	674	669	730	783	829
Nonresidential Investment	487	470	476	482	489	494	498	503	430	472	479	500	517
Structures	169	164	164	165	166	168	170	172	149	166	165	171	176
Equipment	318	306	312	317	323	326	328	331	282	306	315	330	340
Residential Investment	176	178	185	189	189	188	186	185	168	171	185	186	182
Inventory Investment ($ billions)	-6	33	18	23	18	24	31	30	63	6	23	30	32
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	11.3	10.4	9.9	9.7	9.6	9.5	9.3	9.2	13.8	12.2	9.9	9.3	8.8
Real Mortgage Rate	8.0	7.9	7.5	6.9	7.3	6.8	7.2	6.6	9.7	8.9	7.2	6.8	5.8
1-year ARM (without buydown)	9.5	9.1	8.1	7.9	8.3	8.1	8.1	7.9	12.5	10.0	8.3	8.0	7.7
Real Mortgage Rate	6.2	6.6	5.7	5.1	6.0	5.4	6.0	5.3	8.4	6.7	5.6	5.5	4.7
Corporate AAA Bond Rate	10.6	9.6	8.9	8.5	8.3	8.2	8.1	7.9	12.7	11.4	8.8	8.0	7.5
Government Bond Rate	10.2	8.9	7.9	7.5	7.3	7.4	7.3	7.2	12.5	11.0	7.9	7.2	6.8
Real Government Bond Rate	6.9	6.4	5.5	4.7	5.0	4.7	5.2	4.6	8.4	7.7	5.2	4.7	3.8
Federal Funds Rate	8.1	7.8	6.8	6.5	6.7	6.5	6.4	6.2	10.2	8.1	7.0	6.3	6.2
3-month T-Bill Rate	7.2	7.0	6.1	5.8	6.1	5.9	5.9	5.6	9.5	7.5	6.2	5.7	5.6
Real 3-month T-Bill Rate	3.9	4.5	3.7	3.0	3.8	3.2	3.8	3.0	5.4	4.2	3.5	3.2	2.6
1-Year T-Bill Rate	7.9	7.5	6.5	6.3	6.7	6.5	6.5	6.3	10.9	8.4	6.7	6.4	6.1
Real 1-Year T-Bill Rate	4.6	5.0	4.1	3.5	4.4	3.8	4.4	3.7	6.8	5.1	4.0	3.9	3.1
Prime Rate	9.5	9.4	8.6	8.3	8.3	8.3	8.4	8.1	12.0	9.9	8.6	8.1	7.6
Discount Rate	7.5	7.4	6.6	6.3	6.1	6.2	6.1	6.0	8.8	7.7	6.6	6.0	5.8

<1> Historical Data courtesy of Coldwell Banker
<2> FHA Secondary Mortgage Market Rate

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

Special Supplement

Macroeconomic Impacts of the Senate Finance Committee Proposal

The so-called tax reform proposal unanimously approved by the Senate Finance Committee (SFC) on May 7 is likely to reduce the long-run growth potential of the U.S. economy and to pose considerable risk of a recession in the short-run should it be enacted into law. Conceptually, the basic thrust of the SFC proposal is to cut personal and corporate tax rates while expanding the tax base by limiting or repealing many personal and business deductions so as to raise roughly the same amount of tax revenue as current law (i.e., revenue neutrality). However, while aggregate federal revenues are projected to remain roughly constant, personal tax revenues are expected to decline by roughly $100 billion over five years. This cut in personal taxes is financed through an increase in tax burden on income earned from capital assets, particularly real estate. The reduction in personal taxes would encourage greater consumption spending while the increase in taxes on capital assets would create disincentives for capital formation relative to current law, thereby discouraging investment. Over time, the composition of Gross National Product (GNP) would shift toward consumption and away from investment, resulting in a significant loss in the economy's long-run growth potential.

The decline in personal taxes and resulting increase in consumption spending is likely to provide stimulus to the economy. However, this stimulus should be somewhat muted due to particular features of this proposal. In 1987 the tax base would be broadened effective January 1 while marginal tax rates would not be reduced until July 1. Consequently, personal disposable income would decline in 1987, the fifth year of the current economic expansion. Secondly, the loss of personal interest deductibility will raise the after-tax financing cost for consumer durables such as automobiles, furniture, and major appliances which should somewhat offset the effect of increased disposable income.

While stimulating consumption spending, the SFC proposal would discourage capital formation in new equipment, commercial and industrial structures, and both rental and owner-occupied housing. The proposal will increase the rental price of investment through repeal of the investment tax credit, lengthening of depreciation periods for structures, repeal of the capital gains exclusion, and loss limitation provisions. The after-tax cost of owner-occupied homes would rise in response to a devaluation of the traditional homeownership itemized deductions due to lower marginal tax rates and the increase in the standard deduction.

Table 3 presents the results of a macroeconomic simulation of the SFC proposal using the Washington University Macro Model. On balance, the overall rate of economic growth is depressed significantly by the proposal, with the level of real GNP reduced by two percent in the second year after enactment and remaining that much lower through the end of the forecast interval. Clearly, the disincentives to capital formation overwhelm the stimulative effects of increased consumption spending, even in the short-run. Within three years of enactment the level of investment in new equipment is reduced by about 13 percent while investment in new nonresidential structures is about 7 percent lower. Initially, total housing starts decline by about 330 thousand units or 17 percent. This decline in starts is made up of a 10 percent decline in single-family units, most of which are owner-occupied, and a nearly 30 percent decline in multi-family starts, most of which are renter-occupied. Sales of existing single-family homes initially decline by over 300,000 units or about 9 percent due to the increase in after-tax homeownership costs. Note that the adverse impact on housing starts and resales subsides over time as mortgage rates decline due to a weakening economy, increases in rents resulting from the initial decline in starts, and a general decline in the value of existing properties. However, this decline in property values reduces household net worth and so acts to dampen consumption spending.

The lower level of economic growth results in slower growth of employment and a higher unemployment rate. Within five years total employment is lower by nearly two million jobs while the unemployment rate is increased by nearly two percentage points. Also, while the SFC proposal may be revenue neutral in a static sense, it is not dynamically revenue neutral in that the lower level of economic growth causes the federal deficit to increase by roughly $30 billion.

Table 3

Macroeconomic Impacts of the Senate Finance Committee Tax Proposal[1]
(percent change from baseline)
unless otherwise noted

	1986	1987	1988	1989	1990	1991
Real GNP	-0.1	-1.5	-2.0	-2.1	-2.1	-2.0
Inflation (Percentage Points)	0.0	-0.2	-0.4	-0.4	-0.3	-0.3
Employment (Millions of Jobs)	0.0	-0.6	-0.9	-1.3	-1.7	-1.9
Unemployment Rate (Percentage Points)	0.1	0.5	1.1	1.4	1.7	1.9
Mortgage Rate (Percentage Points)	0.0	-0.2	-0.4	-0.7	-1.1	-1.3
Housing Starts (Thousands of Units)	0.0	-330	-226	-143	-92	-75
Percent Change	0.0	-17.1	-12.1	-7.6	-4.9	-4.0
Single Family	0.0	-128	-79	-51	-31	-25
Percent Change	0.0	-10.4	-6.5	-4.2	-2.5	-2.1
Multi-Family	0.0	-203	-149	-92	-63	-50
Percent Change	0.0	-29.3	-22.6	-14.0	-9.5	-7.7
Existing Home Sales (Thousands of Units)	0.0	-316	-202	-131	-81	-68
Percent Change	0.0	-8.9	-5.6	-3.6	-2.2	-1.8
Nonresidential Investment						
Equipment	-1.2	-6.4	-10.9	-13.0	-13.7	-13.1
Structures	-0.3	-3.1	-5.9	-6.8	-6.7	-6.8
Federal Deficit (Billions of Dollars)	-1.9	-0.8	28.2	30.1	33.1	33.7

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[1] Assumes no changes in monetary policy from the baseline.

Source: NATIONAL ASSOCIATION OF REALTORS®; simulation produced using the Washington University Macro Model.

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Outlook for the Economy and Real Estate

REALTOR®

Forecasting & Policy
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The Outlook for The Economy and Real Estate

Growth of real or inflation adjusted Gross National Product (GNP) during the first quarter has been revised down to 2.9 percent from 3.7 percent due to less of an improvement in our foreign trade balance than previously reported. All of the first quarter growth was attributed to an accumulation of inventories, while final sales actually declined. The first quarter results, combined with recent economic indicators, strongly suggest that a major inventory correction took place during the second quarter, with real GNP expected to have increased only 1.7 percent. While the impacts of falling oil prices, a depreciating dollar and lower interest rates should boost overall economic activity during the second half of this year, there is growing evidence that the second half rebound will be more modest than previously expected. At this point growth rates of about three percent are expected during the third and fourth quarters, resulting in growth for all of 1986 of 2.3 percent. A major factor in this scaling back of growth during the second half is that our forecast now assumes enactment of tax reform legislation similar to that passed by the Senate later this year to be effective on January 1, 1987. Subsequently, both residential and nonresidential investment spending are weakened over the remainder of this year and the rest of the forecast horizon. Growth of real GNP should remain at about two percent during 1987 and 1988 as tax reform dampens investment spending at the same time that this economic recovery is weakening with age.

Production has been reduced during the second quarter to correct the inventory imbalance created earlier this year. This weakness in production, combined with sharp cutbacks in the hard-hit energy industry, have intensified the sluggishness of the domestic manufacturing sector which has yet to benefit from the depreciation of the dollar. Recent monthly figures underscore these trends. Employment in manufacturing and mining declined by 70,000 jobs in May. Industrial production declined 0.6 percent and the capacity utilization rate of the nation's factories fell below 79 percent largely reflecting cutbacks in auto production and in oil and gas drilling. However, while domestic production has been scaled back the consumer continues to spend. A surge in auto sales due to cut-rate financing incentives buoyed overall consumption in May, while a strong housing market has boosted residential investment and consumer demand for furniture and other household durables. Therefore, while the increase in final sales should add about 3.9 percentage points to real GNP growth for the second quarter, the depletion of inventories should subtract about 2.2 percentage points from growth for a net growth rate for the quarter of about 1.7 percent.

It was earlier believed that the positive impacts of lower oil prices, a declining dollar, and falling interest rates would lift the economy out of its current doldrums during the second half of this year. However, recent monthly indicators show no real momentum building. For example, the Index of Leading Economic Indicators rose a modest 0.2 percent in May. Further, the all but certain passage of tax reform legislation later this year should further dampen this rebound as businesses scale back already modest investment spending. While lower oil prices have had and will continue to have positive effects on the economy, many analysts have underestimated the negative effects of lower oil prices in the form of cuts in domestic oil production and sharply scaled back investment plans by domestic energy firms. The positive effects of the depreciating dollar may also be slower to materialize than previously expected as the trade deficit rose in May. U.S. exports are expected to improve during the last half of this year but these gains will lead to only modest improvement in the trade deficit and should not make a major contribution to economic growth until 1987. While the stimulus from falling interest rates has boosted housing, overall investment, particularly multi-family housing and nonresidential structures, will be considerably dampened by tax reform. Given these developments the rebound in the last half of 1986 will be modest in both strength and duration with growth of about three percent expected followed by slower growth in 1987.

The downward pressure on inflation from the sharp drop in oil prices appears to have diminished. In May, the Consumer Price Index (CPI) increased 0.2 percent after declining a full 1.1 percent during the previous three months. Gasoline prices, which had declined 26.5 percent in the 3-month period ending in April, advanced 2.5 percent and were responsible for the reversal in this index in May. During the last half of 1986, as the effects of lower oil prices continue to subside, the underlying inflation that is present in the service sector of the economy will become more apparent in the monthly inflation figures. However, given the large declines in energy prices so far this year, the level of inflation for all of 1986 should be about two percent compared to 3-1/2 percent in 1985. By 1987, the upward pressure on prices of imports from a declining dollar should dominate the inflation picture, leading to a mild reacceleration of inflation with the CPI increasing about three percent.

The civilian unemployment rate increased 0.2 percentage points in May to 7.3 percent due mainly to layoffs in manufacturing and mining industries. Also contributing to the May increase was an inflow of college students into the labor force who have not yet been able to find a summer job. On the bright side, employment in construction and the service sector--especially finance and real estate--recorded healthy gains in May as lower interest rates continue to stimulate the housing industry. However, given the assumption of tax reform, the outlook for unemployment is not bright. By 1987, slower overall economic growth should reduce employment growth, pushing the unemployment rate to the upper seven percent range.

Monetary Policy and Interest Rates

As expected, interest rates have been edging downward over the past few weeks and have nearly returned to the levels of mid-April. Yields on 30-year Treasury bonds, which rose to about 7.9 percent by early June, are now back down to 7.2 percent. Similarly, yields on 3-month Treasury bills have dipped below six percent after rising to 6.4 percent in early June. Rates have declined in response to continued indicators of a sluggish economy and growing anticipation that the FED will further ease credit conditions in the next few weeks, including an additional cut in the discount rate from 6-1/2 percent to six percent, in order to spur the economy. There is also a growing expectation that this easing of credit conditions in the U.S. will be coordinated with similar actions in both Japan and West Germany as both countries experienced a decline in overall economic activity during the first quarter of this year. In fact, the Japanese economy contracted at an annual rate of 2.1 percent during the first quarter in response to the appreciation of the yen, the first quarterly decline in more than a decade.

With sluggish economic growth resulting in an easing of aggregate credit demand and the likelihood of further easing of monetary policy by the FED, interest rates are expected to continue to gradually trend downward over the remainder of 1986 and into 1987 and 1988. By the end of this year interest rates on 30-year fixed-rate mortgages, currently averaging about 10 percent, should decline to below 9-1/2 percent. Over the course of 1987 that interest rate should decline about another one-half percentage point.

While the further easing by the FED appears imminent, it should be noted that within the FED there appears to be substantial apprehension of the potentially inflationary impact of such action. M1, the nation's basic money supply of currency and checkable deposits, has been growing very rapidly this year and is well above the FED's target range. In recent months the broader measures of the money supply, M2 and M3, have also begun growing rapidly and are now approaching the top of their target ranges. Some members of the FED, particularly Chairman Paul Volcker, fear that such rapid growth of the money supply combined with the decline in the value of the dollar could result in a major resurgence of inflation later this year or in 1987. Outweighing these fears, however, is the concern that the current sluggish growth of the economy could deteriorate into recession, particularly in view of the depressing effect of tax reform on business investment spending. For example, the two newest members of the Board of Governors, Vice Chairman Manuel Johnson and Wayne Angell, have stated publicly that they do not regard a resurgence of inflation as likely and are more concerned about the current weakness of the economy. Also, with just four months remaining before elections, Senate Majority Leader Dole has publicly expressed that interest rates need to be reduced to stimulate the economy. Under these circumstances, it appears that the FED will chose to err on the side of monetary ease.

The Federal Budget

House and Senate conferees have finally adopted a budget for FY87. While this budget does reach the Gramm-Rudman-Hollings deficit target of $144 billion, it is based on overly optimistic economic assumptions. Consequently, if growth of real GNP falls below the three percent rate assumed in congressional budget projections, which is highly likely, the deficit will exceed the target imposed by GRH and the automatic across-the-board spending cuts may be enforced. Further, the budget has failed to account for the effects of tax reform which is likely to have a dramatic impact on federal receipts over the next five years. In fact, by 1987, slower economic growth brought on by tax reform should lead to slower growth of federal tax revenues and cause the federal deficit to start increasing again. Any attempts to lower the deficit in 1988 through further cuts in spending would severely dampen growth of the economy so that Congress may abandon the GRH targets altogether.

Real Estate Markets

Existing single-family home sales remained robust in May as homebuyers continued to take advantage of the lowest mortgage interest rates in more than seven years. Resales proceeded at a 3.45 million unit annual pace, down slightly from April's 3.57 million pace but up nearly 14 percent from a year ago. New housing units were started at a seasonally adjusted annual rate of 1.888 million units in May, down from 2.039 million units in April but 12 percent ahead of a year ago. All of the decline in housing starts in May occurred in the multifamily category, probably reflecting the chilling effect of the Senate tax reform proprosal. The surge in housing demand has resulted in much faster rates of price appreciation. The median price of existing homes sold in May was $84,400, 12.2 percent above the median of May of 1985. This was the highest rate of appreciation recorded since November of 1980. Similarly, median price of new homes sold in May was 15 percent above the level of a year ago.

As interest rates are expected to edge down modestly over the remainder of this year and into 1987 and 1988, we would normally expect the resale market to continue to improve while housing starts should trail off slighly due to declining demographic demand. However, tax reform is likely to seriously disrupt housing markets. While roughly 600,000 multi-family housing starts are expected this year, they are likely to drop by about 25 percent to around 500,000 units in both 1987 and 1988. Single-family resales and starts are also likely to be depressed as homebuyers and lenders adjust to significant increases in after-tax homeownership costs. For all of 1986 about 3.5 million existing homes should be sold while about 1.25 million new single-family homes are started. In 1987 resales should remain at about 3.5 million units rather than rising to 3.6 million or higher as had been previously been expected. About 1.1 million single-family starts are expected in 1987, down about 150,000 units or 11 percent over the 1986 level. Home prices are also likely to be depressed as a result of tax reform so that rates of home price appreciation in 1987 and 1988 should be considerably lower than they otherwise would have been.

July 1986

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,059	4,116	4,154	4,217	4,275	4,316	4,352	4,388	3,775	3,989	4,190	4,372	4,582
% Change	4.3	5.7	3.8	6.2	5.6	4.0	3.4	3.4	11.0	5.7	5.1	4.3	4.8
% Change (w/out inflation)	0.7	2.9	1.7	3.3	3.2	1.7	0.9	0.8	6.6	2.2	2.3	1.9	1.9
Consumption	0.1	3.8	5.1	2.3	2.1	1.1	0.7	0.5	4.4	3.3	3.1	1.6	1.8
Durables	-13.3	-0.7	16.3	4.5	4.1	-3.3	-2.5	-1.7	12.4	8.4	3.9	0.7	1.6
Nondurables	0.6	6.6	2.9	1.7	1.5	1.6	1.0	0.7	3.4	2.3	3.0	1.5	1.8
Services	4.4	3.1	3.4	2.1	2.0	2.1	1.5	1.1	3.0	2.5	2.9	1.9	1.9
Residential Investment	5.7	9.7	12.9	3.2	0.8	-7.6	-14.7	-13.1	13.2	1.7	7.8	-5.8	-3.3
Nonresidential Investment	11.3	-13.3	1.4	2.7	3.6	-0.5	-2.7	-1.9	19.5	9.7	0.3	0.0	-1.2
Structures	7.2	-15.4	-0.9	1.2	3.2	1.0	0.5	0.4	14.7	11.4	-2.2	1.1	0.4
Equipment	13.5	-12.1	2.6	3.5	3.8	-1.2	-4.3	-3.1	22.2	8.8	1.6	-0.5	-2.0
Exports	6.6	6.6	6.1	5.4	6.2	6.2	6.8	6.7	6.2	-3.0	3.6	6.3	5.6
Imports	24.5	2.4	3.1	0.9	-0.1	-2.3	-4.0	-5.1	22.8	2.7	8.2	-2.0	-2.9
Government Purchases	9.2	-13.8	-1.2	1.3	1.0	1.3	1.1	1.0	4.3	6.0	0.3	1.0	0.9
Contribution to GNP Growth (Percentage Points)													
Consumption	0.1	2.5	3.3	1.5	1.4	0.7	0.5	0.3	2.2	1.9	2.2	0.7	1.3
Residential Investment	0.3	0.5	0.6	0.2	0.0	-0.4	-0.8	-0.7	0.2	0.3	0.3	-0.6	0.2
Nonresidential Investment	1.4	-1.9	0.2	0.3	0.5	-0.1	-0.3	-0.2	1.9	[illegible]	-0.2	-0.3	-0.1
Structures	0.3	-0.8	0.0	0.1	0.1	0.0	0.0	0.0	0.6	0.4	-0.2	0.0	0.0
Equipment	1.1	-1.1	0.2	0.3	0.3	-0.1	-0.4	-0.3	1.3	0.5	-0.1	-0.3	-0.1
Inventory Change	-0.5	4.7	-2.2	0.6	0.5	0.2	0.1	-0.2	0.4	-1.2	0.9	0.0	0.0
Net Exports	-2.3	0.3	0.2	0.4	0.6	1.0	1.3	1.4	-1.5	-1.2	0.4	1.2	0.7
Government Purchases	1.8	-3.0	-0.2	0.3	0.2	0.3	0.2	0.2	1.5	1.5	-0.7	0.2	0.2
Mfg. Capacity Utilization Rate	80.1	80.0	78.8	79.1	79.5	79.2	78.8	78.3	80.8	80.3	79.3	78.6	78.6
Domestic Auto Sales	7.0	7.9	7.9	7.5	7.7	7.8	7.6	7.3	8.0	8.3	7.8	7.5	7.1
Personal Income Per Household	40,531	41,053	41,329	41,667	42,013	42,389	42,700	42,986	38,175	40,029	41,508	42,851	44,477
Percent Change -- Year Agc	4.3	3.9	3.7	4.3	3.7	3.3	3.3	3.2	10.4	4.9	3.7	3.2	3.8
Personal Taxes Per Household	6,143	6,091	6,176	6,250	6,312	6,282	6,337	6,389	5,420	5,987	6,206	6,277	6,208
Percent Change -- Year Ago	8.9	-0.5	10.8	3.4	2.8	3.1	2.6	2.2	12.2	10.5	3.6	1.2	-1.1
Percent of Personal Income	15.2	14.8	14.9	15.0	15.0	14.8	14.8	14.9	14.2	15.0	15.0	14.6	14.0
Disposable Personal Income Per Household	34,388	34,962	35,153	35,417	35,701	36,107	36,362	36,598	32,755	34,042	35,302	36,574	38,269
Percent Change -- Year Ago	3.5	4.7	2.6	4.3	3.8	3.3	3.4	3.3	8.3	3.9	3.7	3.6	4.6
Employment (millions) (civilian:household basis)	108.0	108.8	109.0	109.1	109.5	109.5	109.6	109.9	105.0	107.2	109.1	109.8	111.0
% Change	3.0	2.9	0.7	0.6	1.3	0.2	0.1	1.3	4.1	2.1	1.8	0.6	1.1
Unemployment Rate (%) (civilian)	7.0	7.1	7.1	7.3	7.2	7.4	7.6	7.7	7.5	7.2	7.2	7.7	7.9
Consumer Prices (CPI)	4.4	1.4	-2.0	3.2	2.6	2.8	3.1	3.2	4.3	3.5	1.9	2.9	3.3
GNP Deflator	3.3	2.9	2.0	2.8	2.3	2.3	2.4	2.5	4.1	3.3	2.8	2.5	2.8
Personal Cons. Inflation	4.4	1.1	1.1	3.2	2.6	2.8	3.0	3.1	4.1	3.2	2.3	2.8	3.1
Residential Construction Inflation	5.7	2.6	2.2	2.7	3.2	2.8	2.8	3.2	4.2	1.9	2.8	2.9	3.1
Nonresidential Const. Inflation	0.8	3.2	3.3	3.0	2.8	3.2	3.1	3.4	0.5	1.4	2.3	3.1	3.5
Producer Price Inflation	4.7	-5.7	-5.2	1.0	2.1	3.3	3.6	4.0	2.1	0.9	-1.3	2.4	4.2
Before Tax Corporate Profit	234	217	221	240	249	241	235	229	238	225	232	233	243
Corporate Tax Liability	87	80	95	102	114	111	109	107	94	85	98	106	101
After-Tax Profits	147	137	126	138	135	130	126	122	144	140	134	128	143
Inventory Valuation Adjustment	-10	18	5	-5	-9	-12	-14	-17	-5	-1	2	-16	-19
Capital Consumption Allowance	79	79	85	89	94	98	101	105	41	71	87	103	100
Federal Tax Receipts (NIPA)	804	804	822	839	856	858	863	868	725	785	830	856	860
% of GNP	19.8	19.5	19.8	19.9	20.0	19.9	19.8	19.8	19.2	19.7	19.8	19.6	18.8
Federal Expenditures (NIPA)	1030	1013	1003	1010	1017	1027	1037	1048	898	985	1011	1043	1088
% of GNP	25.4	24.6	24.2	23.9	23.8	23.8	23.8	23.9	23.8	24.7	24.1	23.8	23.7
Deficit(NIPA)	-227	-209	-181	-171	-161	-169	-175	-180	-173	-200	-180	-187	-227
% of GNP	5.6	5.1	4.4	4.0	3.8	3.9	4.0	4.1	4.6	5.0	4.3	4.3	5.0
% of Net Domestic Savings	74.4	62.0	61.6	58.9	56.2	57.5	60.2	63.1	51.1	63.5	59.8	62.8	69.5

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy. Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

Table 2

July 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,542	4,467	4,686	4,780	4,880	4,735	4,657	4,561	3,933	4,254	4,703	4,605	4,308
Percent Change -- Year Ago	18.6	11.2	14.9	9.2	7.4	6.0	-0.6	-4.6	5.1	8.5	10.7	-1.9	-6.4
Existing Single-Family Sales (1000's)	3,500	3,257	3,471	3,580	3,670	3,601	3,571	3,508	2,866	3,214	3,494	3,526	3,202
Percent Change -- Year Ago	24.4	10.3	14.0	6.5	4.9	10.6	2.9	-2.0	5.7	12.1	8.7	0.9	-9.2
Dollar Volume (billions)	318.9	307.3	348.5	369.4	371.6	356.5	378.1	386.0	247.1	291.3	349.2	369.0	348.4
Existing Home Prices - Median ($1000's)	75.2	78.1	83.0	85.0	80.5	81.2	87.2	90.1	72.4	75.5	81.6	85.7	88.3
Percent Change Year - Ago	4.5	4.6	9.9	11.0	7.0	4.0	5.0	6.0	3.0	4.3	8.1	5.0	3.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	565	543	543	539	494	491	525	538	618	609	530	513	492
Percent of Median Family Income	26.1	24.8	24.6	24.2	22.0	21.7	23.0	23.3	28.2	26.2	23.9	22.3	20.6
Housing Starts (1000's)	1,773	1,988	1,941	1,932	1,945	1,736	1,648	1,579	1,763	1,741	1,951	1,627	1,669
Percent Change -- Year Ago	10.0	12.9	11.4	14.5	9.7	-12.7	-15.1	-18.3	3.4	-1.2	12.1	-16.6	2.6
Single-Family Units (1000's)	1,074	1,248	1,253	1,237	1,248	1,169	1,120	1,085	1,100	1,073	1,246	1,112	1,141
Percent Change -- Year Ago	2.5	13.6	17.2	18.0	16.2	-6.3	-10.6	-12.3	3.3	-2.5	16.2	-10.8	2.6
Multi-Family Units (1000's)	699	740	688	695	697	566	528	494	663	669	705	515	528
2-4 Family Units (1000's)	80	101	94	95	96	78	72	68	122	93	97	71	72
Percent Change -- Year Ago	-30.7	0.0	-7.7	6.4	19.8	-23.5	-23.2	-28.9	2.8	6.3	4.3	-26.9	1.4
5+ Family Units (1000's)	620	639	594	599	602	489	456	426	512	576	609	445	456
Percent Change -- Year Ago	37.6	13.8	3.8	9.0	-2.9	-23.5	-23.2	-28.9	7.0	-23.4	5.7	-26.9	2.5
Mobile Homes Shipped	288	262	265	265	269	262	258	255	295	283	245	257	268
New Single-Family Home Sales (1000's)	696	789	772	765	759	680	658	633	637	689	771	645	602
Percent Change -- Year Ago	12.8	18.3	13.5	7.6	9.0	-13.9	-14.7	-17.2	1.7	8.1	11.9	-16.3	-6.7
New Home Prices - Median ($1000's)	86.8	88.0	91.5	93.2	94.9	94.9	95.2	95.3	80.0	84.1	91.9	95.2	98.9
Percent Change -- Year Ago	8.1	6.2	8.9	12.5	9.3	7.8	4.0	2.3	6.1	5.1	9.3	3.6	3.9
New Home Prices--Mean ($1000's, Quality Adj.)	106.4	104.6	107.8	108.7	109.7	107.5	111.0	111.9	96.8	104.0	107.7	110.8	114.3
Percent Change -- Year Ago	7.5	3.4	3.6	4.2	3.1	2.7	2.9	3.0	6.6	7.4	3.6	2.9	3.1
NAR Affordability Index	95.7	100.6	101.2	102.9	113.1	114.8	108.2	106.3	76.6	86.2	104.5	111.3	120.5
Mortgage Debt Outstanding ($ billions)	2,260	2,309	2,389	2,461	2,535	2,606	2,676	2,746	1,948	2,163	2,423	2,711	2,995
Housing Inventory (millions)	95.8	96.3	96.8	97.3	97.8	98.2	98.7	99.1	93.4	95.2	97.0	98.9	100.5
Rental Vacancy Rate(%)	6.7	6.9	6.8	6.7	6.7	6.6	6.6	6.5	5.8	6.5	6.8	6.6	6.4
Office Vacancy Rate (%)<1>	16.5	16.6	16.8	16.8	16.9	17.0	16.8	16.7	13.9	16.0	16.8	16.8	16.4
Industrial Vacancy Rate (%) <1>	4.9	4.9	4.8	4.6	4.5	4.3	4.3	4.2	4.7	4.7	4.7	4.3	4.0
FINANCIAL MARKETS													
Money Supply (M1)(% change)	11.1	7.9	16.2	8.6	7.4	5.3	3.8	4.2	7.0	9.1	11.2	6.3	4.9
Velocity of M1 (% change)	-6.1	-2.1	-10.7	-2.2	-1.7	-1.3	-0.4	-0.8	3.7	-3.1	-5.5	-1.9	-0.1
Value of the U.S. Dollar (Trade-Weighted)	128.2	119.5	114.0	112.0	110.9	109.7	108.6	107.2	138.3	143.2	114.1	107.9	105.9
Percent Change	-28.1	-24.5	-17.1	-6.8	-4.0	-4.0	-4.0	-5.0	10.4	3.5	-20.3	-5.5	-1.8
Flow of Funds (NIA Basis) (Billions of dollars, saar)													
Sources: (total: gross savings)													
Private Saving	694	723	693	697	700	717	723	729	693	694	703	736	800
Personal Saving	115	126	110	101	100	114	116	117	173	129	109	122	151
Savings Rate	4.0	4.4	3.8	3.4	3.3	3.8	3.8	3.8	6.5	4.6	3.7	4.0	4.7
Gross Business Savings	579	597	583	596	601	604	608	612	521	565	594	614	649
Federal Deficit	-227	-209	-181	-171	-161	-169	-175	-180	-173	-200	-180	-187	-227
State & Local	59	65	58	57	58	57	55	53	64	59	59	54	52
Net Foreign Investment	153	141	143	140	140	135	134	132	91	115	141	132	116
Uses (total: gross investment)	681	717	707	722	736	738	733	727	674	669	721	730	738
Nonresidential Investment	487	470	471	474	479	478	475	473	430	472	473	474	468
Structures	169	162	161	162	163	164	164	164	149	166	162	164	165
Equipment	318	308	310	312	315	314	311	309	282	306	311	310	303
Residential Investment	176	180	185	187	187	183	176	170	166	171	185	174	168
Inventory Investment ($ Billions)	-6	35	15	20	25	26	28	26	63	6	24	26	22
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage	11.3	10.4	9.8	9.5	9.2	9.1	9.0	9.0	13.8	12.2	9.8	9.0	8.3
Real Mortgage Rate	8.0	7.5	7.8	6.7	6.9	6.8	6.6	6.5	9.7	8.9	7.0	6.6	5.5
1-year ARM (without buydown)	9.6	9.2	8.1	8.0	7.9	7.9	8.0	7.8	12.6	10.1	8.3	7.9	7.9
Real Mortgage Rate	6.3	6.3	6.1	5.2	5.6	5.6	5.6	5.3	8.5	6.8	5.5	5.5	5.1
Corporate AAA Bond Rate	10.6	9.6	9.0	8.7	8.4	8.3	8.3	8.2	12.7	11.4	8.9	8.2	7.6
Government Bond Rate	10.2	8.9	7.8	7.5	7.3	7.1	7.1	7.1	12.5	11.0	7.9	7.1	6.8
Real Government Bond Rate	6.9	6.0	5.8	4.7	5.0	4.8	4.7	4.8	8.4	7.7	5.1	4.7	4.0
Federal Funds Rate	8.1	7.8	6.8	6.7	6.6	6.4	6.2	6.1	10.2	8.1	7.0	6.2	6.2
3-month T-Bill Rate	7.2	7.0	6.0	5.9	5.7	5.7	5.8	5.6	9.5	7.5	6.1	5.6	5.6
Real 3-month T-Bill Rate	3.9	4.1	4.0	3.1	3.4	3.4	3.4	3.1	5.4	4.2	3.3	3.2	2.8
1-Year T-Bill Rate	7.9	7.5	6.4	6.3	6.2	6.2	6.3	6.1	10.9	8.4	6.6	6.2	6.2
Real 1-Year T-Bill Rate	4.6	4.6	4.4	3.5	3.9	3.9	3.9	3.6	6.8	5.1	3.8	3.8	3.4
Prime Rate	9.5	9.4	8.6	8.3	8.2	8.1	8.0	7.8	12.0	9.9	8.6	7.9	7.7
Discount Rate	7.5	7.4	6.6	6.2	6.1	5.9	5.8	6.0	8.8	7.7	6.6	5.9	5.8

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy. Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

Special Supplement

The Impact of the Senate Finance Committee Tax Reform Proposal on Commercial and Rental Residential Real Estate

To pay for an aggregate decline in personal tax revenues of roughly $100 billion over five years the Senate Finance Committee proposal would increase the tax burden on income earned from capital assets by an equal amount, with $50 to $60 billion derived from real estate. This higher tax burden on commercial and rental residential real estate would be achieved through the following changes in tax law:

1) The extension of the depreciation period for structures from the current law 19 years, with the option of using either the straight-line or the 175 percent declining balance methods, to 27-1/2 years straight-line for residential properties and 31-1/2 years straight-line for commercial properties. This reduces the value of depreciation deductions over the typical real estate investment holding period by 35 to 50 percent. Depreciation schedules for existing investments would be grandfathered.

2) The repeal of the capital gains exclusion, thereby boosting the maximum capital gains tax rate from 20 percent to 27 percent. This provision would be retroactive in that it would apply to all existing real estate investments sold after enactment as well as those undertaken after enactment.

3) The disallowance of the deduction of losses from real estate investments against income from other sources. Active investors, those who "actively participate" in the management of the property, would be allowed to use losses up to $25,000 to offset other income. However, this $25,000 exception would be phased out for taxpayers with incomes between $100,000 and $150,000. This provision would be phased in over five years but would apply to existing investments. This is particularly onerous and unfair since it does not differentiate between cash flow losses and losses due to depreciation which are just as real but are not incurred out-of-pocket. Moreover, this provision would in effect deny to real estate investors depreciation deductions based on 15-, 18-, and 19-year schedules promised them by law as incentives to undertake the risks of investment.

Table 3 presents estimates of the impact of these proposals on yields provided by commercial and rental residential real estate investments placed in service after enactment of the proposal and the increases in rents or declines in property values that would be required to return yields to current law levels. Impacts are differentiated between commercial real estate, where under current law straight-line depreciation tends to be used, and rental residential real estate, where the 175 percent declining-balance method tends to be used. Impacts are also differentiated between active investors such as sole proprietors or general partners and passive investors such as limited partners since passive investors would face stricter limits on deductions of losses. Estimates are provided assuming 10 percent equity (90 percent loan-to-value ratio) and 25 percent equity (75 percent loan-to-value ratio).

Under the Senate Finance Committee proposal yields on real estate investments would decline at least 20 percent and as high as 50 percent, depending upon the type of property, type of investor, and financing terms. Declines in yields of this magnitude would undoubtedly have a severe impact on the commercial and rental residential real estate markets. The market reaction to these reduced yields could be one of two things: i) either a significant decline in the value of all existing properties with greatly reduced rates of investment in new properties, or

ii) rent increases. Since it is unlikely that rents could rise sufficiently in the short run to return yields to current law levels, the most likely scenario is that values of existing properties would decline and new investment would be cut back. Thus, under this proposal values of existing commercial properties could decline as much as 10 to 20 percent while values of existing rental residential properties could decline as much as 15 to 25 percent.

Table 3
Impact of Senate Finance Committee Proposal on
Commercial and Residential Real Estate Investment
Yields, Required Rents, and Property Values

10% Equity

	Decline in Yield	Increase in Rents	Decline in Property Values
Commercial			
Active Investor	-35.6%	+10.0%	-16.5%
Passive Investor	-38.4%	+11.6%	-18.8%
Residential			
Active Investor	-46.1%	+14.9%	-22.9%
Passive Investor	-48.1%	+16.2%	-24.5%

25% Equity

	Decline in Yield	Increase in Rents	Decline in Property Values
Commercial			
Active Investor	-17.2%	+6.5%	-11.6%
Passive Investor	-20.4%	+7.0%	-12.3%
Residential			
Active Investor	-24.0%	+9.8%	-16.4%
Passive Investor	-27.5%	+10.2%	-16.7%

Over time, as the population and the economy grow, the corresponding increase in demand for rental space would interact with the slower increase in supply due to the decline in new investment to boost rents above what they otherwise would be without this proposal. For example, commercial rents would have to rise 7 to 12 percent and residential rents would have to rise 10 to 16 percent to return yields to current law levels.

To put these rent increases in perspective, today the typical renter has an income of about $14,500 while the typical monthly rent is about $350. Under this proposal that typical monthly rent would rise about $35 to $55 for an additional annual payment of $420 to $660. While renters tend to be non-itemizers and so would benefit from a reduced tax burden under this proposal, the annual decline in federal taxes for the typical renter would be about $500. Thus, it is quite likely that the reduced tax burden enjoyed by the typical renter would be totally absorbed by eventual rent increases.

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Outlook for the Economy and Real Estate

REALTOR®

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The Outlook for the Economy and Real Estate

Growth of the economy slowed considerably in the second quarter as real or inflation adjusted Gross National Product (GNP) increased at an anemic 1.1 percent annual rate. This compares to a revised 3.8 percent growth rate for the first quarter. In response to the run-up in inventories during the first quarter, a major inventory correction occurred during the second quarter, dampening overall growth. While aggregate demand, particularly consumer spending, has been strong in response to declining interest rates and lower energy prices a large part of this demand continues to be satisfied by existing inventories and imports. As a result domestic production has weakenened and our trade deficit has continued to deteriorate. The economy is expected to rebound during the second half of this year, however, this pick-up in growth should be mild in both strength and duration. Consumption, a source of strength in the first half, should begin to slow while the contribution of residential investment to GNP growth also is expected to subside. While the weakness in business investment spending is likely to continue both net exports and inventory investment are expected to add modestly to growth during the second half. Overall, growth during the third quarter should be about 2.6 percent, rising slightly to 2.8 percent during the fourth quarter. For all of 1986 growth is expected to be 2.7 percent, the same as 1985. Both Gramm-Rudmann-Hollings (GRH) and tax reform are likely to have adverse effects on aggregate demand through the remainder of 1986 and into 1987. Although the House-Senate Conference Committee must still work out the details, the final bill appears certain to kill the Investment Tax Credit, raise post-tax construction costs and boost corporate taxes by $15-$20 billion annually, leading to a dampening of investment spending. These factors in addition to the fact that this recovery is in its fourth year should cause GNP growth to slow to an annual rate of 1.5 percent in 1987.

The various sectors of the economy experienced sharply contrasting growth patterns from the first to the second quarter. Here are some highlights of the first half of 1986:

		Contribution to Growth	
		1st Quarter	2nd Quarter
		(Percentage Points)	
0	Consumer Expenditures were quite strong in the first half of 1986 as massive refinancing of long-term debt at lower interest rates and lower energy prices left consumers with more money to spend on other goods and services.	2.3	3.8
0	Residential Investment remains one of the few bright spots in the economy as lower mortgage interest rates continue to stimulate demand for housing.	0.5	0.7
0	Net export growth improved during the first quarter, resulting in most of the unexpected upward revision to GNP growth. However, this trend was reversed in the second quarter as imports increased a sharp 20 percent, due largely to increases in petroleum imports, while exports rose a meager 3 percent. A further deterioration in the nation's trade deficit resulted.	0.7	-2.2

0	Business investment has remained weak during the first half of 1986. Firms apparently accelerated their spending at the end of last year to take advantage of investment incentives that might be repealed or scaled back by the current tax reform legislation. Further, cut-backs in domestic oil production have reduced investment in structures (i.e., oil rigs), exacerbating the continued weakness in business investment.	-2.1	-0.3
0	Government Purchases for goods and services declined during the first quarter as the government attempted to stay within the range of the GRH deficit targets. However, government purchases rebounded during the second quarter due in large part to increases in government expenditures in the form of Commodity Credit Corporation (CCC) purchases and defense spending. CCC is a federal program whereby the government purchases crops at support prices.	-2.6	1.4
0	The change in business inventories was largely responsible for the upturn in growth in the first quarter and the subsequent downturn in the second. Businesses accumulated large inventories during the first quarter, boosting GNP growth by 5.1 percent. However, during the second quarter, businesses were able to trim these unwanted inventories, subtracting 2.2 percentage points from GNP growth.	5.1	-2.2
	Total	3.8	1.1

The depreciation of the dollar has yet to significantly benefit sales of U.S.-produced goods domestically or abroad. It was expected that a lower value of the dollar relative to other currencies would stimulate sales of U.S. exports, discourage demand for imports and lead to an improvement in the trade balance. So far, however, these events have failed to occur for a variety of reasons:

0 While the dollar has depreciated sharply against the Japanese yen and the German mark, a large and increasing portion of our imports come from the "Four Tigers" (Taiwan, South Korea, Hong Kong and Singapore) whose currencies have not appreciated relative to the dollar.

0 In many of those countries against whose currencies the dollar has depreciated, economic growth has been slow and as a result demand for U.S. exports remains sluggish.

0 Many firms exporting to the U.S. have sacrificed some of their profits rather than raise prices. On the other hand, domestic firms facing foreign competition have raised their prices in attempts to improve profit margins rather than regaining market share.

- 0 Many products imported from Japan are subject to explicit or implicit voluntary quotas. Many Japanese firms would like to and could export a lot more than their allotted quota, so that even if they do increase prices they very likely could continue exporting the same volume of products to the U.S.

- 0 The lower prices for imported oil have increased demand for petroleum imports which were largely responsible for the strong growth in imports during the second quarter.

- 0 The magnitude of the dollars' depreciation may be overstated. The current trade-weighted exchange rate reported by the FED is outdated. If this index were revised to take account of the more recent trade patterns with countries like the "Four Tigers", then the dollar would have probably declined only 10 percent over the past year instead of 30 percent.

The record U.S. trade deficit should begin to improve by next year as export growth picks up relative to the growth in imports. Contributing to this improvement will be weaker growth in the U.S. that will slow the demand for imports and stronger foreign expansions which should boost demand for U.S. exports.

The civilian unemployment rate fell from 7.1 percent to 6.9 percent in July as a result of strong growth in employment accompanied by a decline in the size of the labor force. This improvement is deceiving, however, as about 150,000 of the 390,000 increase in nonfarm payroll employment was due to striking workers returning to work. Further, while the service sector continues to experience healthy employment gains, after accounting for returning strikers in July, manufacturing employment fell for the fourth consecutive month. The unemployment rate should remain above 7 percent for the remainder of this year. However, as growth slows in 1987, growth in employment should decline, boosting the unemployment rate to above 7-1/2 percent.

The key factor restraining inflation over the past several months has been the decline in oil prices. For all of 1986 the inflation rate should be about 2 percent compared to 3.5 percent for 1985. The benefit of cheaper oil is subsiding so that inflation is expected to accelerate modestly over the remainder of this year and through 1987 and 1988. However, the outlook for inflation remains favorable as wage growth continues to be modest. Average hourly earnings have increased only 2.6 percent over the past year. This compares to a 3.1 percent rate of increase over the previous 12 month period. Also, sluggish growth in production has kept the utilization rate of the nation's factories well below the rate normally associated with inflationary pressures. As a result inflation should accelerate to about 3.0 percent in 1987 and 3.8 percent in 1988.

The Federal Deficit

The federal deficit has re-emerged as a major topic of conversation as sluggish growth of the economy has boosted the federal deficit for FY1986. The second quarter deficit was revised up by $50 billion dollars at an annual rate, raising the expected FY1986 deficit to about $220 billion. Despite the enactment of GRH the FY1986 deficit is likely to be the highest in history. If the GRH deficit target of $172 billion for fiscal year 1986 is not met it will make it even more difficult to reach the $144 billion required for FY1987. Further, tax reform is expected to result in revenue losses starting 1988, making the task of meeting the GRH targets even more difficult. Just for FY1987 spending reductions of roughly $60 billion are required, making GRH unworkable. All is not lost, however, since the deficit should be below what it otherwise would have been if Congress had failed to address the issue of spiraling federal deficits.

Earlier this month, the GRH provision calling for the Comptroller General of the General Accounting Office (GAO) to compute automatic cuts in spending if Congress is unable to meet those targets was found unconstitutional by the Supreme Court. However, the Senate has passed a provision that would allow the Office of Management and Budget(OMB) instead of GAO to implement automatic across-the-board cuts in spending. If the House also agrees that OMB can make the automatic cuts in spending then the pressure will be off Congress to decide where to cut. If the House does not agree with the Senate, then much of the teeth will have been taken out of GRH. Without the threat of automatic cuts Congress appears to have little appetite for making the large spending cuts required to meet the GRH targets.

Monetary Policy

The FED reduced its discount rate one-half percentage point to 6 percent effective July 11; its lowest level since January 1978. This was the third cut in the discount rate this year. The FED action was taken partly in recognition of the decline in market interest rates but also to help spur the sluggish economy. Interest rates continue to be volatile, especially at the long end of the market. The bond market remains nervous as the quarterly refunding by Treasury takes place and the appetite of Japanese investors for U.S. securities remains uncertain. The 30-year bond rate, which was back down to about 7.1 percent in mid-July, is now back up to 7 1/2 percent. Further, mixed signals about the strength of the economy continue to to add to market jitters. Despite this set back, interest rates should decline gradually over the remainder of this year and through 1987. The 30-year treasury bond rate is expected to decline to about 7.1 percent by the end of this year and to 6.9 percent by the end of 1987. The 3 month T-Bill is expected to decline to 5.7 percent by the end of this year and to 5.6 percent by the end of 1987.

Paul Volcker, Chairman of the Federal Reserve Board, testified before the Senate Banking Committee on the Federal Reserves' mid-year report to Congress.
The FED voiced concern about the sluggishness of economic growth and has chosen to temporarily ignore the rapid growth in the nation's basic money supply, M1. However, despite the easing of monetary policy, evidence suggests that during the current period of sluggish growth the FED is not being aggressive enough. In a period of lower inflation expectations accompanied by tax reform and fiscal restraint, the nominal or market interest rates should be falling as much if not more, leaving the real (inflation-adjusted) interest rate unchanged or lower. This is not expected to occur. In fact, long-term real interest rates are actually expected to rise over the next few months.

Volcker also suggested that the FED is no longer going to wait for West Germany and Japan to lower their interest rates. Instead, the U.S. will take the lead if domestic economic conditions warrant. As a result, further reductions in U.S. interest rates relative to foreign interest rates are likely to lead to further declines in the dollar. This in turn would have a negative impact on the trade balance of these countries and so is likely to induce them to follow easier monetary policies.

Real Estate Markets

The market for existing single-family homes has remained healthy. While the seasonally adjusted annual rate of existing single-family homes sales has leveled off in the last several months, the pace of about 3.47 million homes has been substantially ahead of last year's. Single family starts also remained robust with a seasonally adjusted annual rate of 1.23 million homes started during the second quarter.

Regionally, the Midwest has experienced the strongest growth in existing home sales over the past year with a 15 percent increase. The Northeast follows with a 13.3 percent increase over last year. While the South recorded a healthy pace of 10.2 percent, the West exhibited only modest growth in home sales with a 3.7 percent increase over last year.

Despite the decline in mortgage rates expected for the remainder of this year and into 1987, the pace of both resales and single family starts should begin to slow. The slowdown in single family starts and sales will be due to slower growth compounded by tax reform as homebuyers adjust to increases in after-tax homeownership costs. For all of 1986 about 3.45 million homes will likely be sold while about 1.25 homes will be started. By 1987, resales should remain near the 3.4 million level instead of rising to above the 3.5 million level projected before tax reform was incorporated into the forecast.

Home prices continue to increase at a healthy pace with the median home price for June up 7.6 percent over last year. The pace of appreciation should remain strong through the remainder of 1986 with an annual rate of increase of 8.0 percent expected for the year. As the demand for housing levels off and effects of tax reform are felt, the rate of appreciation of homes should slow to about 5 percent in 1987 and 1988.

Tax reform will pose an interesting problem to loan underwriters. As the marginal tax rates decline the cost of owning your own home rises relative to other goods. Therefore the "rule-of-thumb" debt service-to-income ratio of 28 percent is likely to be lowered because under tax reform the value of the mortgage interest and property tax deductions will be reduced causing after-tax homeownership costs to rise as a percentage of the homeowners after-tax income.

The most hard hit sectors of real estate will be multi-family units and office and commericial construction. Not only will tax reform seriously depress these areas of investment but rising vacancy rates in both rental and office units will also further dampen construction. Multi-family starts have already begun to decline in anticiapation of the adverse effects of tax reform.

Table 1

August 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (GNP) (billions of dollars)	4,149	4,182	4,233	4,290	4,322	4,364	4,404	4,447	3,765	3,998	4,214	4,384	4,609
% Change	6.2	3.2	4.9	5.4	3.1	3.9	3.7	3.9	10.5	6.2	5.4	4.0	5.1
% Change (w/out inflation)	3.8	1.1	2.6	2.8	0.6	1.3	1.0	1.1	6.4	2.7	2.7	1.5	2.5
Consumption	3.6	5.9	3.1	2.6	0.8	1.1	1.0	0.4	4.7	3.5	3.7	1.8	1.9
Durables	-1.8	14.8	4.7	4.0	-6.6	-0.5	0.2	-1.4	12.7	7.8	3.9	0.3	2.3
Nondurables	6.5	7.1	2.6	2.0	1.8	1.1	0.9	0.7	3.6	1.6	4.0	1.9	1.7
Services	3.2	2.5	3.1	2.5	2.3	1.5	1.2	0.7	3.4	3.7	3.5	2.1	1.8
Residential Investment	11.0	15.4	2.4	-0.8	-7.6	-9.7	-8.2	-5.3	14.3	3.9	8.3	-4.2	-1.9
Nonresidential Investment	-15.1	-2.6	2.7	4.2	-0.4	-1.3	-0.6	-2.6	16.9	9.3	-0.7	0.3	-0.3
Structures	-10.8	-35.7	2.5	5.9	2.3	2.8	2.6	1.5	11.1	7.7	-9.7	0.0	2.0
Equipment	-17.0	17.1	2.8	3.4	-1.5	3.0	-2.0	-4.2	20.0	10.1	3.8	0.5	1.4
Exports	7.1	3.0	4.6	5.6	6.1	6.0	6.0	6.0	6.2	-2.0	3.4	5.6	5.2
Imports	0.2	20.1	3.9	2.6	-1.3	-2.7	-3.1	3.8	23.2	3.8	9.6	0.6	-1.6
Government Purchases	-12.3	7.0	3.2	9.9	-8.3	0.4	3.2	7.3	4.0	6.8	2.9	1.3	0.7
Contribution to GNP Growth (Percentage Points)													
Consumption	2.3	3.8	2.0	1.7	0.5	0.7	0.6	0.2	2.4	2.3	2.5	0.5	1.6
Residential Investment	0.5	0.7	0.1	0.0	-0.4	-0.5	-0.4	-0.3	0.2	0.4	0.3	-0.4	0.1
Nonresidential Investment	-2.1	-0.3	0.3	0.5	-0.1	-0.2	-0.1	-0.3	1.7	0.8	-0.4	0.2	0.0
Structures	-0.5	-1.7	0.1	0.2	0.1	0.1	0.1	0.1	0.5	0.1	-0.5	0.1	0.0
Equipment	-1.6	1.4	0.2	0.3	-0.1	-0.3	-0.2	-0.4	1.2	0.7	0.1	-0.2	0.0
Inventory Change	5.1	-2.2	-0.5	-1.4	1.5	0.2	-0.8	-1.1	0.2	-1.1	0.2	-0.1	0.2
Net Exports	0.7	-2.2	-0.1	0.2	0.8	1.0	1.1	1.2	-1.4	-1.1	-0.4	1.0	0.5
Government Purchases	-2.6	1.4	0.6	1.9	-1.8	0.1	0.6	1.4	1.5	1.6	0.3	0.1	0.1
Mfg. Capacity Utilization Rate	79.9	79.1	78.9	79.1	78.5	78.2	77.8	77.5	80.8	80.3	79.2	78.0	78.0
Domestic Auto Sales	7.8	8.1	7.8	7.5	7.3	7.2	7.1	7.0	8.0	8.2	7.8	7.2	7.0
Personal Income Per Household	41,477	41,945	42,131	42,521	42,929	43,298	43,663	44,034	38,154	40,285	42,011	43,487	45,392
Percent Change -- Year Ago	4.5	4.5	4.4	3.8	2.3	2.8	2.7	2.6	11.5	5.6	4.3	3.5	4.4
Personal Taxes Per Household	6,011	6,036	6,098	6,186	6,176	6,262	6,348	6,433	5,393	5,913	6,082	6,306	6,067
Percent Change -- Year Ago	2.2	2.3	2.5	2.9	2.3	2.7	2.6	4.2	13.3	9.6	2.9	3.7	-3.8
Percent of Personal Income	14.5	14.4	14.5	14.5	14.4	14.5	14.5	14.6	14.1	14.7	14.5	14.5	13.4
Disposable Personal Income Per Household	35,466	35,909	36,033	36,335	36,753	37,036	37,315	37,600	32,761	34,372	35,929	37,181	39,324
Percent Change -- Year Ago	5.5	3.8	4.8	4.1	2.4	2.8	2.7	2.3	9.0	4.9	4.5	3.5	5.8
Employment (millions) (civilian:household basis)	108.8	109.2	109.4	109.7	109.6	109.7	109.8	110.0	105.0	107.2	109.3	109.8	111.0
% Change	2.9	1.7	0.6	1.1	-0.2	0.2	0.5	0.4	4.1	2.1	2.0	0.5	1.1
Unemployment Rate (%) (civilian)	7.1	7.2	7.3	7.2	7.5	7.8	7.9	8.0	7.5	7.2	7.2	7.8	7.7
Consumer Prices (CPI)	1.4	-1.7	3.0	3.1	3.7	3.5	3.6	3.7	4.3	3.5	2.0	3.1	3.8
GNP Deflator	2.5	2.1	2.3	2.5	2.5	2.6	2.7	2.8	3.9	3.3	2.7	2.5	3.1
Personal Consumption Inflation	1.1	1.1	3.2	3.2	3.6	3.3	3.3	3.5	3.8	3.5	2.1	3.1	3.6
Residential Construction Inflation	3.0	3.3	2.9	3.0	3.4	3.5	3.6	3.8	4.1	1.8	3.0	3.3	4.1
Nonresidential Construction Inflation	3.7	0.9	0.8	1.7	2.5	3.1	3.3	3.2	-0.2	0.7	1.3	2.3	3.5
Producer Price Inflation	-5.8	-5.1	1.4	2.0	3.6	3.4	3.5	3.9	2.1	0.9	-1.3	2.4	3.9
Before-Tax Corporate Profits	224	234	247	266	253	252	252	261	236	223	243	254	269
Corporate Tax Liability	89	93	105	114	138	137	117	120	95	92	100	128	123
After-Tax Profits	135	141	141	153	115	116	136	140	140	131	143	127	146
Inventory Valuation Adjustment	17	6	-1	-1	-6	-5	-3	-5	-6	-1	5	-5	-5
Capital Consumption Allowance	56	51	53	51	49	46	43	40	35	58	53	45	32
Federal Tax Receipts (NIPA)	800	803	823	838	869	877	866	878	727	787	816	872	862
% of GNP	19.3	19.2	19.4	19.5	20.1	20.1	19.7	19.7	19.3	19.7	19.4	19.9	18.7
Federal Expenditures (NIPA)	1,002	1,040	1,033	1,066	1,049	1,057	1,075	1,102	897	985	1,035	1,071	1,112
% of GNP	24.1	24.9	24.4	24.9	24.3	24.2	24.4	24.8	23.8	24.6	24.6	24.4	24.1
Deficit(NIPA)	-202	-236	-210	-228	-180	-181	-210	-225	-170	-198	-219	-199	-250
% of GNP	4.9	5.7	5.0	5.3	4.2	4.1	4.8	5.1	4.5	4.9	5.2	4.5	5.4
% of Net Domestic Savings	59.7	72.6	72.5	78.2	70.5	72.1	78.7	84.3	51.8	63.4	70.4	76.5	81.3

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns

Table 2

REAL ESTATE AND FINANCIAL MARKETS

August 1986

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,472	4,670	4,740	4,776	4,654	4,583	4,505	4,416	3,933	4,254	4,665	4,540	4,562
Percent Change -- Year Ago	11.3	14.5	8.3	5.2	4.1	-1.9	-4.9	-7.5	5.1	8.2	9.6	-2.7	0.5
Existing Single-Family Home Sale	3,257	3,470	3,525	3,567	3,512	3,461	3,410	3,337	2,868	3,214	3,455	3,430	3,446
Percent Change -- Year Ago	10.3	14.0	4.9	1.9	7.8	-0.3	-3.3	-6.4	5.7	12.1	7.5	-0.7	0.5
Dollar Volume (billions)	307	349	355	355	350	360	360	350	247	291	342	355	376
Existing Home Prices - Median ($1000's)	78.1	81.9	83.3	82.6	82.8	85.9	87.1	86.6	72.4	75.5	81.5	85.6	89.8
Percent Change -- Year Ago	4.6	8.5	8.7	9.8	6.0	4.9	4.5	4.8	3.0	4.3	7.9	5.0	4.9
Monthly Mortgage Payment (P&I. 80%, 30 yr.)	583	586	542	524	500	513	521	511	618	609	559	511	515
Percent of Median Family Income	25.2	24.8	23.8	22.7	22.3	22.7	22.8	22.2	33.4	29.7	24.1	22.5	21.7
Housing Starts (1000's)	1,998	1,908	1,890	1,834	1,747	1,660	1,627	1,592	1,763	1,741	1,908	1,656	1,671
Percent Change -- Year Ago	13.4	9.5	12.0	3.4	-8.4	-12.2	-11.3	-8.9	3.4	-1.2	9.5	-13.2	0.9
Single-Family Units (1000's)	1,253	1,237	1,252	1,247	1,177	1,157	1,129	1,113	1,100	1,073	1,247	1,144	1,150
Percent Change -- Year Ago	14.0	15.8	19.5	16.1	-4.8	-7.6	-9.4	-5.5	3.3	-2.5	16.3	-8.3	0.5
Multi-Family Units (1000's)	746	671	638	587	570	503	498	479	663	669	660	512	521
2-4 Family Units	102	80	75	70	67	60	59	57	122	93	82	61	62
Percent Change -- Year Ago	0.7	-21.6	-15.5	-12.8	-15.7	-21.1	-15.3	-15.9	7.0	-23.4	-12.2	-25.8	1.7
5+ Family Units	644	591	562	518	502	443	439	422	542	576	579	452	459
Percent Change -- Year Ago	14.7	3.3	2.2	-16.5	-15.0	-21.2	-15.2	-15.9	2.8	6.2	0.5	-21.9	1.7
Mobile Homes Shipped	262	241	246	249	243	244	243	243	295	283	250	243	254
New Single Family Home Sales (1000's)	782	725	695	688	668	673	670	663	636	688	722	668	644
Percent Change -- Year Ago	17.2	6.6	-2.3	-1.1	-14.6	-7.2	-3.6	-3.6	1.7	8.1	4.9	-7.5	-3.7
New Home Prices -- Median ($1000)	88.0	91.6	93.4	95.1	95.1	95.2	95.1	95.1	80.0	84.3	92.0	95.1	98.5
Percent Change -- Year Ago	6.2	9.0	12.0	9.6	8.1	4.0	1.8	0.0	6.0	5.4	9.1	3.4	3.6
New Home Prices -- Mean ($1000's,Quality Adj.)	104.5	107.9	113.5	109.7	107.5	111.4	117.3	113.6	96.8	104	108.9	112.5	117.1
Percent Change -- Year Ago	3.7	4.3	3.1	5.0	-0.4	-1.9	6.9	5.7	1.6	7.4	4.7	3.3	4.1
NAR Affordability Index	100.6	101.2	104.7	109.9	111.9	110.0	109.2	112.3	89.1	95.5	104.1	110.9	114.9
Mortgage Debt Outstanding($ billions)	2,309	2,389	2,409	2,478	2,555	2,629	2,702	2,775	1,948	2,202	2,396	2,665	2,960
Housing Inventory (millions)	96.3	96.8	97.3	97.7	98.2	98.6	99.1	99.5	93.4	95.2	97.0	98.8	100.5
Rental Vacancy Rate (%)	6.9	7.1	7.0	6.9	6.9	6.8	6.7	6.7	5.8	6.5	7.0	6.8	6.6
Office Vacancy Rate (%)<1>	16.6	16.8	16.8	16.9	17.0	16.8	16.7	16.6	13.9	16.0	16.8	16.8	16.4
Industrial Vacancy Rate (%) <1>	4.9	4.8	4.6	4.5	4.3	4.2	4.2	4.2	4.7	4.7	4.7	4.3	4.0
FINANCIAL MARKETS													
Money Supply (M1)(% change)	7.9	16.7	11.0	8.2	5.6	5.6	4.7	5.0	7.0	9.1	11.6	7.2	5.7
Velocity of M1 (% change)	-1.6	-11.5	-5.5	-2.5	-2.4	-1.6	-0.9	-1.1	3.3	-2.6	-5.6	-3.0	-0.5
Value of the U.S. Dollar (Trade-Weighted)	119.5	114.2	110.0	108.7	107.5	106.3	105.1	103.8	138.3	143.2	113.1	105.7	103.8
Percent Change	-24.5	-16.5	-14.0	-4.5	-4.5	-4.5	-4.5	-4.5	10.4	3.5	-21.0	-6.6	-1.7
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	715	719	690	696	667	671	697	705	675	688	705	635	765
Personal Saving	146	156	128	120	131	129	129	132	169	143	137	130	176
Savings Rate	5.0	5.2	4.3	4.0	4.3	4.2	4.1	4.2	6.3	5.1	4.6	4.2	5.3
Gross Business Savings	569	563	562	576	536	542	568	574	506	544	568	555	588
Federal Deficit	-202	-236	-210	-228	-180	-181	-210	-225	-170	-198	-219	-199	-250
State & Local	70	59	57	59	58	56	55	55	69	62	61	56	56
Net Foreign Investment	129	134	136	143	144	148	148	146	91	115	135	146	142
Uses (total:gross investment)	708	691	694	688	703	703	695	684	662	661	696	696	715
Nonresidential Investment	458	455	458	463	462	461	460	457	422	461	458	460	458
Structures	148	133	133	135	136	137	138	138	141	152	137	137	140
Equipment	310	322	324	327	326	323	322	318	281	309	321	322	318
Residential Investment	186	193	194	194	190	185	181	178	171	177	192	184	180
Inventory Investment ($ Billions)	40	20	15	2	16	18	10	-0	59	9	19	11	10
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	10.4	9.9	9.5	9.2	9.1	9.0	9.0	8.9	13.8	12.2	9.7	9.0	8.6
Real Mortgage Rate	7.4	7.3	7.4	7.4	6.7	6.9	7.2	7.4	9.6	8.5	7.3	7.0	6.9
1-year ARM (without buydown)	9.2	8.3	8.0	7.9	7.8	7.8	7.7	7.7	12.6	10.1	8.4	7.8	7.7
Real Mortgage Rate	6.2	5.7	5.9	6.1	5.4	5.7	5.9	6.2	8.2	6.4	6.0	5.8	6.0
Corporate AAA Bond Rate	9.6	9.0	8.8	8.7	8.6	8.3	8.3	8.2	12.7	11.4	9.0	8.3	7.9
Government Bond Rate	8.9	7.5	7.3	7.1	6.9	7.0	6.9	6.9	12.5	11.0	7.7	6.9	6.6
Real Government Bond Rate	5.9	4.9	5.1	5.3	4.5	4.9	5.1	5.4	12.5	7.3	5.3	4.9	4.8
Federal Funds Rate	7.8	6.9	6.4	6.3	6.3	6.2	6.2	6.1	10.2	8.1	6.9	6.2	6.1
3-month T-Bill Rate	7.0	6.1	5.9	5.8	5.7	5.7	5.6	5.6	9.5	7.5	6.2	5.7	5.5
Real 3-month T-Bill Rate	4.5	4.0	3.6	3.3	3.2	3.1	2.9	2.8	5.6	4.2	3.5	3.2	2.4
1-Year T-Bill Rate	7.5	6.6	6.3	6.2	6.1	6.1	6.0	6.0	10.9	8.4	6.7	6.1	6.0
Real 1-Year T-Bill Rate	5.0	4.5	4.0	3.7	3.6	3.5	3.3	3.2	7.0	5.1	4.0	3.6	2.9
Prime Rate	9.4	8.6	8.3	8.2	8.1	8.1	8.0	7.8	12.0	9.9	8.6	8.1	7.5
Discount Rate	7.4	6.6	6.0	6.0	5.8	5.8	5.8	5.7	8.8	7.7	6.5	5.8	5.7

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

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Outlook for the Economy and Real Estate

REALTOR®

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The Outlook for the Economy and Real Estate

Growth of real (inflation-adjusted) Gross National Product (GNP) was revised down to an unexpected 0.6 percent annual rate during the second quarter. A further deterioration in growth of net exports and a downward adjustment of inventories contributed to the slowdown. A sharp decline in nonresidential investment also dampenened growth. However, the second quarter growth figure did conceal some strength in demand for domestically-produced goods which rebounded 6.8 percent. During the last half of the year, growth is expected to rebound modestly as most of the factors that contributed to the slowdown in the second quarter -- large increases in petroleum imports and a downward correction to inventories -- are not expected to re-occur and growth in consumption is expected to expand at a modest pace. As a result, growth is expected to rebound modestly to 2.3 percent during the third quarter and to 2.5 percent during the fourth quarter.

The outlook for the remainder of 1986 depends heavily on the performance of trade. In the absence of a sharp deterioration in net exports, the continued growth in domestic demand could stimulate a much-needed rebound in production and lift the manufacturing sector out of its current slump. However, the prospects of an improvement in the merchandise trade deficit have been clouded by recent monthly data. The July merchandise trade balance recorded a deficit of $18 billion, indicating a further deterioration from the June trade deficit of $14 billion rather than an improvement. The July report underscored the fact that the continued penetration of U.S. markets has to a large extent come from newly industrialized Asian countries, whose currencies have not appreciated against the dollar. Therefore, a further depreciation of the dollar against the Japanese Yen and the German Marc will not necessarialy lead to an improvement in the nations' trade performance. While it is likely that July's merchandise trade deficit will be revised down as more complete data on transactions are reported, a modest deterioration in the trade deficit is expected through the rest of the year, and as a result, growth during the second half will not be as strong as previously expected. However, if the trade deficit deteriorates markedly through the last half of the year, the probability of even a modest rebound will be diminished.

Deep-discounted auto financing and the imminent passage of tax reform are expected to bolster consumption over the next six months. Domestic automakers are offering interest rates between 0 and 2.9 percent in order to deplete inventories and make room for next year's models. As a result, new car sales by the "Big Three" automakers -- Ford, G.M. and Chrysler -- have responded favorably increasing 32 percent in early September over the same period last year. Further, repeal of the deductibility of sales taxes beginning in 1987 should induce consumers to accelerate purchases of big-ticket items during the later part of this year. However, while the boost to consumption is expected to sustain economic activity in 1986, it will be at the expense of growth in 1987.

The major factor dampening growth in 1987 will be tax reform. Retaining the basic qualitative features of the Senate and House proposals, the final conference committee bill will repeal the Investment Tax Credit (ITC) and lengthen the depreciation schedule for structures and most equipment thereby dampening overall investment spending next year. Another feature of the bill likely to dampen real estate investment is the loss limitation provision which prevents investors from using losses from real estate investments to offset other types of income. Fiscal restraint associated with Gramm-Rudmann-Hollings is also expected to place a considerable drag on the economy next year. Finally the pace of consumption will slow as rising debt burdens and smaller income gains stifle consumer spending. As a result growth for all of 1987 should reach only 1.7 percent.

The trend in oil prices continues to dominate the outlook for inflation. Oil prices have risen in response to the OPEC production restraint agreement. As a result, overall Consumer Price Inflation (CPI) should reaccelerate modestly to about a 3.3-3.8 percent rate through the end of this year with a 2.1 percent rate expected for all of 1986. By 1987, there will be two opposing forces influencing inflation--a depreciating dollar and continued slack in the labor markets. Putting upward pressure on prices, the impacts of a sharply depreciated dollar will boost import prices. Restraining inflation next year, slower wage gains will help to keep a lid on labor costs. As a result, by 1987, the CPI is expected to increase to about 3.5 percent before accelerating modestly to 4.0 percent in 1988.

The unemployment rate declined to 6.8 percent and nonagricultural payroll employment rose by a healthy 200,000 jobs in August indicating that growth should pick up during the last half of 1986. Within the goods-producing sector, manufacturing employment, which had been on a downward trend over the past 6 months held steady in August. In fact, over half of the manufacturing industries recorded modest increases over last month suggesting a possible end to the current slump in manufacturing. Construction employment also expanded at a healthy pace underscoring the strong growth in housing. In the service-producing sector employment increased by 65,000 jobs with the strongest gains in finance, insurance, and real estate. The unemployment rate is expected to remain near 6.9 percent through 1986, however, slower growth next year is expected to boost the unemployment rate to above 7.5 percent.

Fiscal Policy

The budget outlook has been complicated considerably by tax reform. The tax reform package gains revenues during the first year while losing revenues in 1988. Therefore, the expected shortfall in revenues in 1988 must be offset by further spending cuts if Congress hopes to reach the GRH targets. Further, any attempts by Congress to use the extra revenue in 1987 to meet the GRH targets will further endanger the targets in 1988. These revenue estimates are strongly affected by economic conditions. The budget projections by Office of Management and Budget (OMB) and Congressional Budget Office(CBO) are averaged to determine the growth rate used in projecting the budget. This average growth projection is 3.8 percent for next year. CBO and OMB are also projecting a higher rate of inflation, about 4 percent, which will raise estimates of nominal federal reveneus. If growth continues to remain sluggish and inflation remains below the average projection by OMB and CBO, as is highly likely, actual revenues will fall short of projections making it even harder for Congress to reach the GRH deficit for 1987 and beyond. Currently, we are forecasting growth in the economy of about 1.7 percent an inflation rate of about 3.5 percent. Therefore, the required spending cuts to meet GRH targets in fiscal year 1988 will be so large as to make GRH unworkable.

Monetary Policy

In mid-August the Federal Reserve cut the discount rate, the rate charged to member banks for loans, for the fourth time this year to 5-1/2 percent. Despite substantial declines in short term interest rates, long-term interest rates have been quite volatile and are higher than they were preceeding the second cut in the discount rate this year. Contributing to the volatility in long-term interest rates, the bond market remains jittery about a reacceleration of inflation as the recent agreement by OPEC members limiting production of oil has signaled a bottoming out of oil prices. Further, recent monthly indicators have hinted at a resurgence of growth during the last half of 1986 which could reignite inflationary pressures. However, the recent increase in interest rates will be reversed once credit markets realize that the current resurgence of economic growth will be modest and short-lived. Therefore, the overall trend will be downward through next year as:

- Sluggish growth is expected to persist through next year.
- Tax reform should remove investment incentives, leading to less investment and therefore less demand for credit.
- Fiscal restraint associated with Gramm-Rudmann-Hollings should provide greater assurance that future deficits should not rise.
- Continued moderation in oil prices and slower wage gains should restrain expectations about future inflation

Real Estate Markets

Existing-home sales have responded favorably to the retreat in mortgage interest rates which has enhanced overall affordability. Existing sales in July increased to a seasonally-adjusted annual rate of 3.45 million units. Housing starts, on the other hand, declined by about 2 percent to 1.818 million units in July dampened by tax reform and regional variations. Healthy increases in single-family starts were recorded in the Northeast and Midwest, while declines occurred in the South and West largely because these regions have been experiencing economic problems resulting from slumping energy, mining and agricultural industries.

Over the next year, the benefits of lower mortgage interest rates should be diluted by tax reform and slower growth. While mortgage interest and state and local property tax deductions for homeowners would be maintained under tax reform, the increase in the standard deduction and the loss or limitation of several non-homeownership itemized deductions would increase the cost of homeownership relative to the price of other goods and services people consume. As a result, the demand for housing will be dampenened. Single-family starts are expected to decline about 7 percent to 1.37 units. About 3.40 million existing homes are expected to be sold in 1987, well below the 3.6 million level projected in the absence of tax reform. Further, the imminent passage of tax reform will remove investment incentives in rental residential units and has already begun to dampen multi-family construction which is expected to trend downward through 1987 declining by as much as 23 percent next year.

Nationwide, the median existing single-family home price fell $200 from June to July to $82,400 the second consecutive monthly decline. However, the July median price was a strong 7.4 percent ahead of the $76,700 median recorded a year earlier. Regionally, the largest annual price increase last month occurred in the Northeast, where a 20.0 percent rise to a median $106,300 was recorded. The West followed with a 10.2 percent increase to a median of $105,700. The Midwest posted a 6.3 percent annual gain to $64,000 and the South recorded a 1.9 percent increase to $79,000. Existing homes are expected to appreciate at 7.4 percent rate for all of 1986. By 1987, this rate of appreciation is expected to slow to about 4.7 percent as tax reform increases homeownership costs and dampens overall housing demand.

Contracting for office space is expected to decline to 245 square feet in 1986, a 28 percent decline over 1985, in response to vacancy rates near 20 percent and less generous investment incentives in the House-Senate tax proposal. Construction in the industrial sector will also slow considerably due to the current slump in manufacturing. As a result, new contracts for industrial building are expected to decline to 135 square feet, a 12 percent decline over 1985.

Table 1

September 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,149	4,180	4,230	4,286	4,336	4,379	4,429	4,480	3,765	3,988	4,211	4,408	4,642
% Change	6.2	3.0	4.9	5.4	4.7	4.1	4.6	4.7	10.5	6.2	5.3	4.6	5.4
% Change (w/out inflation)	3.8	0.6	2.3	2.5	1.9	1.0	1.6	1.5	6.4	2.7	2.5	1.7	2.1
Consumption	3.6	6.5	3.2	2.5	2.1	1.9	1.5	1.2	4.7	3.5	3.9	2.4	1.9
Durables	-1.8	16.4	0.7	1.3	0.2	1.2	0.7	0.9	12.7	7.8	3.5	1.7	1.9
Nondurables	6.5	8.4	3.4	2.4	2.1	1.7	1.4	1.3	3.6	1.6	4.4	2.5	1.8
Services	3.2	2.4	3.8	2.9	2.6	2.2	1.8	1.3	3.4	3.7	3.6	2.5	1.9
Residential Investment	11.0	13.5	-1.8	-4.4	-7.9	-9.0	-6.1	-4.0	14.3	3.9	7.1	-5.0	0.1
Nonresidential Investment	-15.1	-2.3	1.0	1.2	0.6	-2.1	-0.4	-3.0	16.9	9.3	-1.0	-0.3	0.2
Structures	-10.8	-38.6	0.0	3.1	1.8	-0.4	1.2	-1.6	11.1	7.7	-10.9	-2.2	1.0
Equipment	-17.0	19.9	1.4	0.4	0.1	-2.8	-1.1	-3.5	20.0	10.1	3.8	0.5	-0.1
Exports	7.1	-5.6	-0.5	3.7	6.9	6.5	7.0	5.6	6.2	-2.0	1.0	4.4	5.7
Imports	0.2	16.5	2.7	2.3	-0.6	-2.0	-3.2	-1.4	23.2	3.8	8.8	0.7	-1.0
Government Purchases	-12.3	9.8	3.0	9.5	-8.8	0.0	2.8	7.1	4.0	6.8	3.3	1.1	0.6
Contribution to GNP Growth (Percentage Point)													
Consumption	2.3	4.2	2.1	1.6	1.4	1.2	1.0	0.8	2.4	2.3	2.6	1.1	1.5
Residential Investment	0.5	0.7	-0.1	-0.2	-0.4	-0.5	-0.3	-0.2	0.2	0.4	0.2	-0.3	0.2
Nonresidential Investment	-2.1	-0.3	0.1	0.1	0.1	-0.3	-0.1	-0.4	1.7	0.8	-0.5	-0.2	0.2
Structures	-0.5	-1.8	0.0	0.1	0.1	0.0	0.0	-0.1	0.5	0.1	-0.6	0.0	0.0
Equipment	-1.6	1.6	0.1	0.0	0.0	-0.2	-0.1	-0.3	1.2	0.7	0.0	-0.2	0.1
Inventory Change	5.1	-3.1	0.0	-1.0	2.0	-0.4	-0.8	-0.9	0.2	-1.1	0.2	0.0	0.0
Net Exports	0.7	-2.7	-0.4	0.0	0.7	0.9	1.1	0.8	-1.4	-1.1	-0.6	0.9	0.6
Government Purchases	-2.6	1.9	0.6	1.9	-1.9	0.0	0.6	1.4	1.5	1.6	0.4	0.0	0.1
Mfg. Capacity Utilization Rate	76.9	79.2	78.2	78.3	78.2	77.8	77.6	77.5	80.8	80.3	78.9	77.8	77.9
Domestic Auto Sales	7.8	8.1	7.9	7.8	7.5	7.4	7.2	7.1	8.0	8.2	7.9	7.3	7.1
Personal Income Per Household	41.477	42,023	42,195	42,595	43,038	43,409	43,810	44,212	38,154	40,285	42,065	43,623	45,491
Percent Change -- Year Ago	4.5	4.7	4.6	4.0	3.8	3.3	3.0	3.8	8.6	5.6	4.4	3.7	4.3
Personal Taxes Per Household	6,011	6,084	6,143	6,231	6,092	6,179	6,269	6,350	5,393	5,913	6,117	6,226	6,046
Percent Change -- Year Ago	-1.0	9.6	3.0	2.8	1.4	1.5	2.1	2.1	6.2	9.6	3.4	1.8	-2.9
Percent of Personal Income	14.5	14.5	14.6	14.6	14.2	14.2	14.3	14.4	14.1	14.7	14.5	14.3	13.3
Disposable Personal Income Per Household	35,466	35,939	36,052	36,365	36,946	37,231	37,540	37,853	32,761	34,372	35,948	37,397	39,445
Percent Change -- Year Ago	5.5	3.9	4.9	4.2	4.2	3.6	4.2	4.1	7.1	4.9	4.6	4.0	5.5
Employment (millions) (civilian:household basis)	108.8	109.2	109.7	109.7	109.9	110.0	110.2	110.4	105.0	107.2	109.4	110.1	111.3
% Change	2.9	1.7	1.7	0.1	0.7	0.4	0.7	0.7	4.1	2.1	2.0	0.7	1.0
Unemployment Rate (%) (civilian)	7.1	7.2	7.0	7.2	7.4	7.6	7.7	7.8	7.5	7.2	7.1	7.6	7.7
Consumer Prices (CPI)	1.4	-1.7	3.3	3.8	4.1	3.8	4.2	3.8	4.3	3.5	2.1	3.5	4.0
GNP Deflator	2.5	2.5	2.4	2.9	2.8	3.0	3.0	3.2	3.9	3.3	2.8	2.8	3.2
Personal Cons. Inflation	1.1	-0.7	3.2	3.7	3.9	3.6	3.9	3.6	3.8	3.5	2.2	3.4	3.7
Residential Construction Inflation	3.0	7.5	3.1	3.2	3.6	3.6	3.8	3.9	4.1	1.8	3.8	3.7	4.1
Nonresidential Const. Inflation	3.7	0.0	1.1	2.4	2.8	3.3	3.1	3.6	-0.2	0.7	1.3	2.5	3.6
Producer Price Inflation	-5.8	-5.1	1.5	2.5	3.9	3.6	4.2	3.8	2.1	0.9	-1.2	2.7	4.0
Before-Tax Corporate Profits	224.3	231.9	250.9	267.9	262.8	261.9	268.0	273.7	235.7	223.1	243.8	266.6	286.7
Corporate Tax Liability	89.1	91.1	105.7	113.1	141.5	139.8	121.5	124.1	95.4	91.7	99.8	131.7	129.0
After-Tax Profits	135.2	140.8	145.2	154.8	121.3	122.1	146.5	149.6	140.3	131.4	144.0	134.9	157.7
Inventory Valuation Adjustment	16.5	7.9	-3.9	-4.4	-8.2	-6.2	-6.6	-4.7	-5.5	-0.5	4.0	-6.4	-5.5
Capital Consumption Allowance	55.6	51.4	52.0	51.6	48.7	45.0	41.4	37.6	34.5	58.1	52.7	43.2	27.5
Federal Tax Receipts (NIPA)	800	806	826	839	864	872	863	875	727	787	818	868	864
% of GNP	19.3	19.3	19.5	19.6	19.9	19.9	19.5	19.5	19.3	19.7	19.4	19.7	18.6
Federal Expenditures (NIPA)	1,002	1,043	1,034	1,067	1,048	1,056	1,072	1,098	897	985	1,036	1,069	1,105
% of GNP	24.1	24.9	24.4	24.9	24.2	24.1	24.2	24.5	23.8	24.6	24.6	24.3	23.8
Deficit(NIPA)	-202	-237	-209	-228	-184	-184	-210	-224	-170	-198	-219	-200	-241
% of GNP	4.9	5.7	4.9	5.3	4.2	4.2	4.7	5.0	4.5	4.9	5.2	4.5	5.2
% of Net Domestic Savings	59.7	72.9	73.1	79.9	71.5	75.1	81.2	87.5	51.8	63.4	70.9	76.8	82.9

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

Table 2 September 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
REAL ESTATE AND FINANCIAL MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,472	4,670	4,645	4,680	4,573	4,522	4,492	4,453	3,933	4,254	4,617	4,510	4,534
Percent Change -- Year Ago	11.3	14.5	6.1	3.1	2.3	-3.2	-3.3	-4.9	4.9	8.2	8.5	-2.3	0.5
Existing Single-Family Home Sale	3,257	3,470	3,480	3,499	3,447	3,410	3,390	3,359	2,868	3,214	3,427	3,402	3,418
Percent Change -- Year Ago	10.3	14.0	3.6	0.0	5.8	-1.7	-2.6	-4.0	5.5	12.1	6.6	-0.7	0.5
Dollar Volume (billions)	307	349	351	348	344	355	358	352	247	291	339	352	372
Existing Home Prices - Median ($1000's)	78.1	82.0	82.8	81.4	81.7	85.8	86.8	85.4	72.3	75.5	81.1	84.9	88.8
Percent Change -- Year Ago	4.6	8.6	8.1	8.2	4.6	4.7	4.8	4.9	3.6	4.4	7.4	4.7	4.6
Monthly Mortgage Payment (P&I. 80%, 30 yr.)	584	587	585	564	551	561	553	538	618	609	580	551	531
Percent of Median Family Income	24.8	24.7	24.5	23.4	22.7	23.0	22.7	22.0	33.0	29.4	24.4	22.6	21.7
Housing Starts (1000's)	1,998	1,908	1,830	1,783	1,691	1,660	1,628	1,609	1,763	1,741	1,880	1,647	1,682
Percent Change	61.3	-16.9	-15.4	-9.9	-19.1	-7.1	-7.6	-4.4	3.4	-1.2	8.0	-12.4	2.1
Single-Family Units (1000's)	1,253	1,237	1,201	1,218	1,161	1,144	1,124	1,120	1,100	1,073	1,227	1,137	1,159
Percent Change	85.1	-4.8	-11.2	5.8	-17.4	-5.9	-6.6	-1.4	3.3	-2.5	14.4	-7.3	1.9
Multi-Family Units (1000's)	746	671	629	565	529	516	503	489	663	669	653	510	523
2-4 Family Units	102	81	76	68	64	62	61	59	122	93	82	62	63
Percent Change	168.7	-60.2	-22.6	-35	-22.8	-9.6	-9.8	-10.7	7	-23.4	-12.1	-24.8	2.6
5+ Family Units	644	590	553	497	466	454	442	430	542	576	571	448	460
Percent Change	16.4	-29.6	-22.6	-35	-22.8	-9.6	-9.8	-10.7	2.8	6.2	-0.9	-21.5	2.6
Mobile Homes Shipped	262	238	240	245	241	242	242	244	295	283	246	242	255
New Single Family Home Sales (1000's)	800	787	725	695	668	670	655	650	637	689	752	661	634
Percent Change -- Year Ago	19.9	15.7	2.0	-0.1	-16.5	-14.9	-9.7	-6.5	1.3	8.1	9.2	-12.1	-4.1
New Home Prices -- Median ($1000)	88.3	91.6	93.1	94.5	94.7	94.8	94.7	94.6	80.0	84.3	91.9	94.7	98.1
Percent Change -- Year Ago	6.2	9.0	12.0	9.6	8.1	4.0	1.8	0.0	6.0	5.4	9.1	3.0	3.6
New Home Prices -- Mean ($1000's,Quality Adj.)	103.2	107.8	108.6	109.7	107.7	111.5	112.4	113.8	96.8	104.0	107.3	111.3	115.8
Percent Change -- Year Ago	2.0	3.6	4.1	3.1	4.3	3.4	3.5	3.7	6.6	7.4	3.2	3.7	4.0
NAR Affordability Index	100.6	101.1	101.8	106.4	109.9	108.5	110.1	113.6	89.1	95.5	102.2	110.6	115.1
Mortgage Debt Outstanding($ billions)	2,303	2,389	2,409	2,478	2,555	2,629	2,702	2,775	1,948	2,202	1,819	2,665	2,960
Housing Inventory (millions)	96.3	96.8	97.3	97.7	98.2	98.6	99.0	99.4	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	6.9	7.3	7.3	7.3	7.2	7.2	7.1	7.0	5.8	6.5	7.2	7.1	6.9
Office Vacancy Rate (%)<1>	16.3	16.8	16.8	16.9	17.0	16.8	16.7	16.6	14.7	16.5	16.7	16.8	16.5
Industrial Vacancy Rate (%) <1>	5.3	5.7	5.8	5.7	5.7	5.6	5.6	5.5	4.7	5.0	5.6	5.6	5.4
FINANCIAL MARKETS													
Money Supply (M1)(% change)	7.9	16.8	13.1	11.0	9.3	7.5	6.5	5.8	7.0	9.1	12.1	9.6	6.2
Velocity of M1 (% change)	-1.6	-11.8	-7.3	-5.0	-4.2	-3.2	-1.8	-1.0	3.3	-2.6	-6.0	-4.6	-0.8
Value of the U.S. Dollar (Trade-Weighted)	119.5	114.2	108.0	106.0	105.2	104.4	103.6	102.8	138.3	143.2	111.9	104.0	100.9
Percent Change	-24.5	-16.5	-20.1	-7.2	-3.0	-3.0	-3.0	-3.0	10.4	3.5	-21.9	-7.1	-3.0
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	715	719	686	689	668	665	686	692	675	688	702	678	746
Personal Saving	146	153	124	113	127	117	111	109	169	143	134	116	149
Savings Rate	5.0	5.1	4.1	3.7	4.1	3.8	3.5	3.4	6.3	5.1	4.5	3.7	4.5
Gross Business Savings	569	566	563	576	542	548	575	583	506	544	568	562	597
Federal Deficit	-202	-237	-209	-228	-184	-184	-210	-224	-170	-198	-219	-200	-241
State & Local	70	60	57	60	60	59	59	59	69	62	62	59	61
Net Foreign Investment	129	138	139	149	153	157	157	156	91	115	139	156	153
Uses (total:gross investment)	708	685	688	682	702	696	691	682	662	661	691	693	719
Nonresidential Investment	458	455	456	458	458	456	455	452	422	461	457	455	456
Structures	148	131	131	132	133	133	133	132	141	152	136	133	134
Equipment	310	324	325	326	326	323	323	320	281	309	321	323	323
Residential Investment	186	192	191	189	185	181	178	177	171	177	190	180	181
Inventory Investment ($ Billions)	40	12	12	3	21	17	10	1	59	9	17	12	12
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	10.4	9.9	9.8	9.5	9.3	9.1	9.0	8.9	13.8	12.2	9.9	9.1	8.6
Real Mortgage Rate<3>	4.4	4.4	4.6	4.7	4.9	4.9	5.1	5.3	6.4	5.5	4.5	5.1	5.3
1-year ARM (without buydown)	9.2	8.3	7.7	7.5	7.3	7.2	7.1	7.0	12.6	10.1	8.2	7.2	6.9
Real Mortgage Rate	3.2	2.7	2.5	2.7	2.9	3.0	3.2	3.4	5.2	3.4	2.8	3.1	3.6
Corporate AAA Bond Rate	9.6	9.0	8.9	8.6	8.2	7.8	7.7	7.6	12.7	11.4	9.0	7.8	7.4
Government Bond Rate	8.9	7.7	7.5	7.3	7.0	6.8	6.7	6.6	12.5	11.0	7.8	6.8	6.4
Real Government Bond Rate	2.9	2.2	2.3	2.5	2.6	2.6	2.8	3.0	5.1	4.3	2.4	2.8	3.1
Federal Funds Rate	7.8	6.9	6.3	6.0	5.8	5.7	5.6	5.5	10.2	8.1	6.7	5.6	5.4
3-month T-Bill Rate	7.0	6.1	5.5	5.3	5.1	5.0	4.9	4.8	9.5	7.5	6.0	4.9	4.7
Real 3-month T-Bill Rate	4.5	3.6	3.1	2.4	2.3	2.0	1.9	1.6	5.6	4.2	3.2	2.1	1.5
1-Year T-Bill Rate	7.5	6.6	6.0	5.8	5.6	5.5	5.4	5.3	10.9	8.4	6.5	5.5	5.2
Real 1-Year T-Bill Rate	5.0	4.1	3.6	2.9	2.8	2.5	2.4	2.1	7.0	5.1	3.7	2.7	2.0
Prime Rate	9.4	8.6	7.8	7.5	7.3	7.2	7.2	6.9	12.0	9.9	8.3	7.1	6.5
Discount Rate	7.4	6.6	5.8	5.5	5.3	5.2	5.0	4.8	8.8	7.7	6.3	5.1	4.8

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates = Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Richard Peach, Jenemarie Mulvey, and Sean Burns.

Special Supplement:

The Falling Dollar and the U.S. Merchandise Trade Deficit

In July, 1986, the U.S. merchandise trade deficit rose to $18.04 billion. This means that imports to the U.S. exceeded exports by the largest monthly margin ever recorded. For the first half of 1986, the trade deficit was $83.9 billion. At the current monthly pace, it could reach almost $200 billion for all of 1986. For reference, the merchandise trade deficit just five years ago amounted to only $28 billion for all of 1981. These large trade deficits have seriously hampered economic growth, being cited as a contributing factor to the recent anemic performance of the U.S. economy.

Beginning in the 1970's, high inflation rates became a built-in factor in planning decisions made by individuals and businesses. These inflation expectations led financial institutions to increase the interest rates they charged to reflect the anticipated higher operating costs. The combination of inflation and high interest rates in the late 1970's attracted foreign capital seeking these higher rates of return available on U.S. investments. Of course, to make these investments foreign investors needed U.S. dollars. This created demands for dollars above and beyond the normal requirements for international trade and capital flows, which raised the price of the dollar in world foreign exchange markets. Deficit federal spending throughout the 1980's has increased the government's demand for credit which in turn has kept real interest rates at very high levels. These high real interest rates available on U.S. investments have sustained foreign investment in the U.S. and resulted in additional demand for the U.S. dollar.

Normally, such a rise in the value of the dollar benefits U.S. consumers because it increases their buying power in world markets. However, the higher dollar was not at first a bonus to U.S. consumers because the economy was suffering through a severe recession in 1981-1982. But as economic growth rebounded in 1983 and came roaring back in 1984, consumers' incomes also rose, allowing them to finally take full advantage of the strong dollar and use it to go on a worldwide buying spree. In the process, U.S. consumers passed over U.S. manufactured goods, instead preferring imported goods selling for unusually low prices due to the high dollar.

Not only did the strong dollar leave U.S. manufacturers hard-pressed to find a market for their products at home, but they were also losing their share of foreign markets that had usually shown strong demand for U.S. exports. This happened because, just as a strong U.S. dollar had made foreign goods cheaper for U.S. buyers, it also made U.S. goods more expensive to buyers in overseas markets. In addition, many foreign countries were not experiencing the same robust economic growth as the U.S., which further weakened foreign demand for U.S. goods. This combination of a strong dollar, rising personal incomes at home and weak foreign demand for U.S. exports were the major factors in the buildup to the high merchandise trade deficits we have today.

In February, 1985, the U.S. dollar began a slow decline. The debate was joined on whether to accelerate the dollar's drop. Many argued that too fast a drop in the dollar's value could re-ignite inflation in the U.S. by raising import prices and thereby reducing price competition for domestic firms. However, the strong pressures of mounting monthly trade deficits mandated that a U.S. policy response be formulated. In September, 1985, a meeting of world finance ministers from the leading industrial nations was called to discuss the decline of the U.S. dollar. The G-5 meeting, as the group came to be known, did succeed in agreeing to and later orchestrating further dollar declines. The hope was to correct world trade imbalances by first shrinking the largest one of them all--the U.S. merchandise trade deficit--through declines in the value of the dollar. Today, the dollar is roughly 30 percent below its average value against other major currencies in February, 1985, and 40 percent lower against the Japanese Yen and German Deutschmark. Since the outset, economists have maintained that a long lag exists between changes in the dollar's value and subsequent changes in the trade deficit. However, lower merchandise trade deficits have yet to materialize apparently because the traditional inverse relationship between the dollar and trade deficits may be subject to a longer lag than is usually the case.

Not surprisingly, many reasons have been offered to explain the longer lag in the dollar-trade deficit relationship that has caused the trade deficit to remain so painfully high. Today, few economists still believe this alone explains the lack of improvement in the trade deficit since the dollar's slide began more than 18 months ago. One generally accepted explanation for the longer lag is that foreign producers of goods exported to the U.S. have trimmed their profit margins more than expected in response to the weaker dollar. The weaker dollar has effectively made foreign goods more expensive to U.S. consumers, but by absorbing some of this added cost (by not increasing prices on their goods by the full amount of the dollar's fall) foreign producers hope to lessen the impact of the falling dollar on U.S. import prices and preserve their share of the lucrative U.S. market. At the same time, some U.S. firms have raised their prices rather than try to take advantage of the dollar's fall to increase their U.S. market share. These U.S. firms are working to restore their profit margins that suffered when the dollar was strong.

A second explanation given concerns the export side of the U.S. merchandise trade deficit. A weaker dollar makes U.S. exports more affordable to consumers in foreign markets. Typically, this sparks increased demand by foreign consumers for U.S. exports. However, many of those foreign markets which have been profitable for U.S. firms in the past are not experiencing economic growth strong enough to support an influx of U.S. goods. Unfortunately, this has continued to be the case despite the lower prices brought on by the weak dollar. For example, economic growth in West Germany and Japan has been relatively weak lately. In fact, U.S. officials have repeatedly asked these two nations to stimulate their respective economies in the hopes of reviving demand for U.S. exports.

A third reason given is that the U.S. dollar has not declined against the currencies of all our trading partners. While it has fallen against the currencies of our major trading partners, there is still a large group of individually small trading partners whose currencies have changed very little in relation to the dollar. Some economists estimate this group to collectively account for almost half of the U.S. merchandise trade deficit. Most significant in this group, along with their share of the U.S. trade deficit, are Taiwan ($1.7 billion), South Korea ($838 million) and Hong Kong ($644 million). The U.S. dollar has fallen less than 10 percent against the currencies of Taiwan and Hong Kong, and actually risen slightly against the currency of South Korea. These countries have not experienced the pressures that a weaker dollar brings to bear on prices offered by foreign producers, and so little improvement in these trade balances is expected.

A fourth reason is that while U.S. imports are valued at the new dollar exchange rate, they are shipped for a time at the same volume because of a lag between changes in the exchange rate and the volume of physical shipments by foreign exporters. This means that the trade deficit can widen in dollar terms yet be the same in volume terms. An example using Japanese exports of Toyota cars to the U.S. is a good way to explain this phenomenon. Before the recent drop in the value of the dollar, the exchange rate of Japanese yen for U.S. dollars was 180 yen per dollar, and a Toyota car exported from Japan at a price of say, 1,800,000 yen would have retailed at $10,000 in the U.S. The exchange rate is now about 150 yen per dollar and the same Toyota car exported to the U.S. would now retail for $12,000. There is a lag of about 3 to 6 months between the change in the yen-dollar exchange rate and a subsequent change in the volume of these shipments. During this lag the volume of Toyota cars remains about the same yet the change in the exchange rate has raised the price of these cars in the U.S. This results in a larger trade deficit with Japan in dollar terms, even though in volume terms shipments of Toyotas have remained the same. So, in some cases a declining dollar can actually appear to temporarily widen the trade deficit.

While there are many explanations offered for why the merchandise trade deficit is so large, how to reduce it given the now uncertain relationship between it and the U.S. dollar is an unsolved puzzle. Further declines in the dollar, often cited as the answer, may also lead to another round of accelerating inflation. Presumably the Federal Reserve Board would be called upon to lower interest rates as a prelude to more dollar declines. However, the Fed, having supposedly rid the economy of inflation, has been easing its grip on the money supply in order to compensate for the shift away from fiscal policy as the engine of economic growth. The Fed now has the unenviable dual task of deciding how low interest rates should fall to keep the economy afloat, while also keeping watch for a resurgence of inflation from faster money supply growth and the falling dollar.

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Outlook for the Economy and Real Estate

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The Outlook for the Economy and Real Estate

Economic growth is expected to rebound only modestly during the second half of the year buoyed in part by consumer spending. The onset of tax reform will likely stimulate spending over coming months as consumers accelerate purchases of big-ticket items in order to deduct sales tax before the January 1 deadline. Further, this "buy-forward" attitude has been reinforced by deep-discounted auto financing as automakers attempt to clear out 1986 models. However, the impact of strong growth in consumer spending on overall economic activity should be diminished as a large part of this demand will continue to be satisfied by imports and existing inventories. The two key developments expected to dampen growth during the last half of the year will be GM's announced cutback in production and the likely further decline in net exports. As a result, growth in real GNP of 2.1 and 2.6 percent is expected in the third and fourth quarters with an annual average rate of growth of 2.5 percent expected for all of 1986.

Fiscal policy is expected to dominate the outlook in 1987 as both tax reform and Gramm-Rudman-Hollings(GRH) have adverse near-term effects on growth. The repeal of the Investment Tax Credit (ITC) and the lengthening of depreciation schedules for structures and most equipment should dampen overall investment spending next year. Real estate investment will likely be "hard-hit" by the loss-limitation provision which prevents investors from using losses from real estate investments to offset other types of income. Further, cutbacks in spending by both the federal government and consumers should also place a considerable drag on economic activity next year. Adherence to GRH deficit targets will restrain spending by the government and rising debt burdens as well as negligable growth in after-tax personal income should limit funds available for household consumption. As a result, real growth in GNP in 1987 is expected to increase at an annual average rate of only 1.6 percent with an expected improvement in net export growth providing the primary stimulus to economic activity. However, this forecast is not without risk. Any combination of the following would likely push the economy into a recession in 1987:

- a further deterioration in the nation's trade performance
- the potential for a steeper decline in investment and residential construction in response to tax reform.
- the failure of the FED to move aggressively to smooth the transition to tax reform and fiscal restraint associated with the GRH Deficit Reduction Law

The outlook for inflation remains quite favorable. The Consumer Price Index increased a modest 0.2 percent in August as shortages in poultry and eggs led to only temporary increases in food prices. Energy prices actually recorded a decline in August suggesting that the agreement by OPEC nations restraining oil production has yet to eliminate the oversupply of petroleum products. In addition, inflation rates for services have subsided, reflecting the slow but steady easing of labor costs in the service-producing industries. A modest re-acceleration in inflation is expected next year as oil prices resume their upward trend once the existing oversupply is diminished. However, continued wage restraint should lower labor costs holding the overall inflation rate to 3.5 percent in 1987 and 4.0 percent in 1988.

The September employment report dashed hopes that more than a modest rebound would occur during the last half of the year. After 3 consecutive months of decline, the civilian unemployment rate rose 0.2 percentage points in September to 7.0 percent. Nonagricultural employment increased a meager 107,000 workers in September. Further, after accounting for the effect of striking workers and others returning from strikes, employment increased just 77,600 after rising 198,000 in August. The report underscored the continued weakness in manufacturing as manufacturing employment, after holding steady in August, resumed it downward trend in September. Even employment in the construction industry, which had been rising in recent months in response to a healthy housing market, recorded no change in September. Employment growth is expected to continue to slow through next year pushing the unemployment rate to above 7.5 percent by the end of 1987.

Long-term interest rates increased over a 1/2 percentage point over the past month spurred in part by anxiety in the bond market about renewed inflation, stronger growth and the recent decline in the dollar. However, most of these fears are not expected to be realized. While rate of inflation should accelerate modestly next year to 3.5 percent, a weakening in economic activity and slower wage gains should keep a lid on overall inflation. Further, while a rebound in the second half of the year is likely, it is expected to be quite modest and followed by renewed weakness in 1987. Finally, the recent depreciation of the dollar has raised concern that foreigners will shy away from dollar-denominated assets for fear of future depreciation. However, so far foreigners continue to have a healthy appetite for U.S. securities and there is little evidence that it will be diminished in the near-term. Subsequently, both long-and short-term interest rates are expected to continue to slowly trend downward through next year and into 1988.

Real Estate Markets

The single-family housing market remains one of the few bright spots in the economy. The annual pace of existing single-family home sales jumped 7.0 percent from July to August to a 3.69 million seasonally-adjusted annual rate -- the highest level during this decade. New construction of single-family units, while retreating below the 1.2 million unit level reported over the past six months, increased at a healthy pace of 1.197 million units in August. Despite an expected decline in mortgage interest rates through 1987, the pace of existing home sales is expected to slow slightly next year in response to slower growth and tax reform. Existing home sales are expected to decline to 3.44 million units in 1987 compared to an expected rate of 3.47 million units in 1986. New construction of housing is also expected to be adversely affected by tax reform, with sharpest declines expected in multi-family housing. In 1987, multi-family starts will likely decline as much as 25 percent, whereas single-family starts are expected to decline about 6 percent.

Table 1

October 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,149	4,176	4,226	4,281	4,327	4,367	4,416	4,468	3,765	3,998	4,208	4,394	4,647
% Change	6.2	2.6	4.9	5.3	4.3	3.8	4.6	4.8	10.5	6.2	5.3	4.4	5.7
% Change (w/out inflation)	3.8	0.6	2.1	2.6	1.4	0.8	1.5	1.7	6.4	2.7	2.5	1.6	2.5
Consumption	3.6	6.2	6.3	0.6	1.4	1.1	1.1	1.2	4.7	3.5	4.1	2.0	2.2
Durables	-1.8	14.3	22.5	10.3	-6.0	-1.5	0.2	1.9	12.7	7.8	5.0	-0.4	3.4
Nondurables	6.5	8.0	3.4	2.6	2.4	1.3	1.1	1.1	3.6	1.6	4.3	2.4	2.0
Services	3.2	2.6	3.7	2.9	2.9	1.8	1.4	1.1	3.4	3.7	3.6	2.5	2.1
Residential Investment	11.0	14.5	-1.7	-3.3	-7.4	-8.9	4.5	-3.5	14.3	3.9	7.4	-4.4	-0.5
Nonresidential Investment	-15.1	-0.9	1.0	-0.7	-0.1	-2.4	1.1	-2.1	16.9	9.3	-0.9	-0.8	0.6
Structures	-10.8	-35.2	-4.8	-3.2	1.1	0.5	2.2	1.3	11.1	7.7	-10.9	-3.3	2.1
Equipment	-17.0	19.6	3.4	0.3	0.6	-3.5	-2.4	-3.4	20.0	10.1	4.0	0.2	0.0
Exports	7.1	-9.8	-1.8	5.8	7.0	6.2	6.1	5.8	6.2	-2.0	0.1	4.2	5.9
Imports	0.2	15.8	5.4	1.6	-1.6	-3.6	-3.6	-3.0	23.2	3.8	9.0	0.1	-1.0
Government Purchases	-12.3	9.7	2.5	9.6	-8.5	0.3	3.2	7.5	4.0	6.8	3.2	1.3	0.9
Contribution to GNP Growth (Percentage Point)													
Consumption	2.3	4.0	4.1	0.4	0.9	0.7	0.7	0.8	2.4	2.3	2.7	0.8	2.0
Residential Investment	0.5	0.7	-0.1	-0.2	-0.4	-0.5	-0.2	-0.2	0.2	0.4	0.2	-0.3	0.1
Nonresidential Investment	-2.1	-0.1	0.1	-0.1	0.0	-0.3	-0.1	-0.3	1.7	0.8	-0.5	-0.2	0.3
Structures	-0.5	-1.7	-0.2	-0.1	0.0	0.0	0.1	0.0	0.5	0.1	-0.6	0.0	0.1
Equipment	-1.6	1.6	0.3	0.0	-0.1	-0.3	-0.2	-0.3	1.2	0.7	0.1	-0.2	0.2
Inventory Change	5.1	-2.7	-1.5	0.2	1.9	-0.4	-0.6	-1.2	0.2	-1.1	0.2	-0.1	0.1
Net Exports	0.7	-3.0	-0.9	0.3	0.9	1.1	1.1	1.0	1.4	-1.1	-0.8	1.0	0.5
Government Purchases	-2.6	1.9	0.5	1.9	-1.8	0.1	0.6	1.5	1.5	1.6	0.4	0.1	0.1
Mfg. Capacity Utilization Rate	79.9	79.2	79.5	79.5	79.2	78.7	78.5	78.4	80.8	80.3	79.5	78.7	79.3
Domestic Auto Sales	7.8	8.1	9.3	7.0	6.9	7.0	6.8	6.8	8.0	8.2	8.1	6.9	7.1
Personal Income Per Household	41,477	41,985	42,188	42,571	42,997	43,358	43,744	44,151	38,154	40,285	42,047	43,568	45,509
Percent Change -- Year Ago	4.5	4.7	4.5	3.9	3.7	3.3	3.7	3.7	8.6	5.6	4.4	3.6	4.5
Personal Taxes Per Household	6,011	6,084	6,142	6,227	6,086	6,170	6,258	6,349	5,393	5,913	6,114	6,216	6,048
Percent Change -- Year Ago	-1.0	9.6	3.0	2.7	1.2	1.4	1.9	2.0	6.2	9.6	3.4	1.7	-2.7
Percent of Personal Income	14.5	14.5	14.6	14.6	14.2	14.2	14.3	14.4	14.1	14.7	14.5	14.3	13.3
Disposable Personal Income Per Household	35,466	35,900	36,046	36,344	36,911	37,188	37,487	37,802	32,761	34,372	35,933	37,352	39,460
Percent Change -- Year Ago	5.5	3.9	4.8	4.1	1.2	1.4	1.9	2.0	7.1	9.6	3.4	1.7	2.7
Employment (millions) (civilian:household basis)	108.8	109.2	110.0	110.0	110.2	110.2	110.4	110.6	105.0	107.2	109.5	110.4	111.7
% Change	2.9	1.7	2.9	0.0	0.6	0.3	0.7	0.8	4.1	2.1	2.2	0.8	1.2
Unemployment Rate (%) (civilian)	7.1	7.2	6.8	7.0	7.2	7.5	7.6	7.6	7.5	7.2	7.0	7.5	7.4
Consumer Prices (CPI)	1.4	-1.7	3.0	4.0	4.1	3.9	3.9	3.8	4.3	3.5	2.0	3.5	3.9
GNP Deflator	2.5	1.8	2.9	2.6	2.8	3.0	3.0	3.1	3.9	3.3	2.7	2.8	3.2
Personal Cons. Inflation	1.1	-1.1	3.0	4.1	4.0	3.7	3.6	3.6	3.8	3.5	2.1	3.4	3.6
Residential Construction Inflation	3.0	5.6	3.3	3.4	3.8	3.8	3.8	3.9	4.1	1.8	3.5	3.8	4.2
Nonresidential Const. Inflation	3.7	-0.4	1.6	1.8	2.9	3.3	3.5	3.5	-0.2	0.7	1.2	2.5	3.7
Producer Price Inflation	-5.8	-5.1	1.4	3.1	3.9	3.7	3.7	3.8	2.1	0.9	-1.2	2.8	4.0
Before Tax Corporate Profit	224.3	231.3	246.8	269.5	258.8	256.2	259.7	268.9	235.7	223.1	245.0	260.9	288.3
Corporate Tax Liability	89.1	93.3	104.7	114.3	140.0	137.5	118.7	122.6	95.4	91.7	109.4	129.7	130.3
After-Tax Profits	135.2	138.0	142.1	155.2	118.8	118.7	141.0	146.3	140.3	131.4	142.6	131.2	158.0
Inventory Valuation Adjustment	16.5	10.6	-2.1	-7.5	-8.2	-6.4	-4.1	-4.8	-5.5	-0.5	4.4	-5.8	-5.7
Capital Consumption Allowance	55.6	51.3	52.0	51.9	48.8	45.0	41.1	37.2	34.5	58.1	52.7	43.0	27.0
Federal Tax Receipts (NIPA)	800	808	825	840	863	869	860	873	727	787	818	866	866
% of GNP	19.3	19.3	19.5	19.6	19.9	19.9	19.5	19.5	19.3	19.7	19.4	19.7	18.6
Federal Expenditures (NIPA)	1,002	1,046	1,034	1,067	1,048	1,056	1,073	1,099	897	985	1,037	1,069	1,107
% of GNP	24.1	25.0	24.5	24.9	24.2	24.2	24.3	24.6	23.8	24.6	24.6	24.3	23.8
Deficit(NIPA)	-202	-238	-209	-227	-185	-187	-213	-227	-170	-198	-219	-203	-240
% of GNP	4.9	5.7	4.9	5.3	4.3	4.3	4.8	5.1	4.5	4.9	5.2	4.6	5.2
% of Net Domestic Savings	59.7	73.4	77.3	81.8	73.7	77.1	82.4	88.2	51.8	63.4	72.4	80.4	83.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

October 1986

Table 2

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,472	4,671	4,742	4,778	4,621	4,593	4,541	4,508	3,933	4,254	4,666	4,566	4,598
Percent Change -- Year Ago	11.3	14.5	8.3	5.2	3.3	-1.7	-4.2	-5.6	5.1	8.2	9.7	-2.1	0.7
Existing Single-Family Home Sales (1000's)	3,257	3,470	3,573	3,579	3,488	3,469	3,421	3,401	2,866	3,214	3,470	3,445	3,460
Percent Change -- Year Ago	10.3	14.0	6.3	2.3	7.1	0.0	-4.3	-5.0	5.5	12.1	8.0	-0.7	0.4
Dollar Volume (billions)	307.4	348.7	338.9	340.4	331.8	336.5	334.5	329.5	247.1	291.3	333.8	333.1	351.3
Existing Home Prices - Median ($1000's)	78.1	82.0	80.0	78.9	81.4	83.9	84.1	82.5	72.4	75.5	79.8	83.0	86.2
Percent Change -- Year Ago	4.6	8.6	4.4	4.9	4.3	2.3	5.1	4.6	3.6	4.4	5.7	4.0	3.9
Monthly Mortgage Payment (P&I,80%,30 yr.)	583.6	587.6	562.0	538.0	518.1	525.3	520.4	505.0	618.0	609.0	567.8	517.2	513.6
Percent of Median Family Inc	25.0	24.9	23.8	22.6	22.5	22.6	22.2	21.3	28.2	26.2	24.1	22.1	21.1
Housing Starts (1000's)	1,998	1,908	1,809	1,791	1,671	1,660	1,629	1,605	1,763	1,741	1,877	1,641	1,678
Percent Change	13.4	9.5	7.2	1.0	-16.4	-13.0	-9.9	-10.4	3.4	-1.2	7.8	-12.5	2.3
Single-Family Units (1000's)	1,253	1,238	1,205	1,236	1,168	1,159	1,155	1,142	1,100	1,073	1,233	1,156	1,173
Percent Change	14.0	15.8	14.9	15.1	-6.8	-6.4	-4.2	-7.7	3.3	-2.5	15.0	-6.2	1.5
Multi-Family Units (1000's)	746	670	604	555	503	501	474	463	663	669	644	485	505
2-4 Family Units	102	80.7	72.6	66.7	60.5	60.2	57	55.7	121.5	93.1	80.5	58.4	60.8
Percent Change -- Year Ago	0.7	-20.9	-18.7	-16.2	-40.7	-25.4	-21.5	16.5	7.0	-23.4	-13.5	-27.5	4.1
5+ Family Units	643.7	589.7	531.0	488.0	442.5	440.3	415.9	401.0	541.9	575.8	563.1	426.8	444.3
Percent Change -- Year Ago	14.7	3.1	-3.5	-21.3	-31.2	-25.3	-21.5	-16.5	2.8	6.2	-2.2	-24.2	4.1
Mobile Homes Shipped	262	238	241	248	242	244	246	247	295	283	247	245	257
New Single Family Home Sales (1000's)	800	787	612	579	577	570	561	566	637	689	695	569	593
Percent Change -- Year Ago	19.9	15.7	-13.9	-16.8	-27.9	-27.6	-8.3	-2.2	1.3	8.1	0.9	-18.1	4.3
New Home Prices -- Median ($1000)	88.3	91.4	93.0	94.3	94.4	94.5	94.5	94.5	80.0	84.3	91.8	94.5	96.4
Percent Change -- Year Ago	6.5	8.8	11.5	8.6	6.9	3.4	1.6	0.2	6.0	5.4	8.9	2.9	2.0
New Home Prices -- Mean ($1000's,Quality Adj.)	102.9	107.8	107.8	110.4	107.6	111.7	111.8	114.6	96.8	104.0	107.3	111.4	116.1
Percent Change -- Year Ago	1.7	3.6	3.4	3.8	4.5	3.6	3.7	3.8	6.6	7.4	3.2	3.8	4.2
NAR Affordability Index	99.9	100.6	104.8	110.2	111.0	110.4	112.5	117.0	75.4	85.9	103.9	112.7	118.6
Mortgage Debt Outstanding($ billions)	2,354	2,389	2,422	2,488	2,556	2,620	2,684	2,748	1,948	2,202	2,413	2,652	2,911
Housing Inventory (millions)	96.3	96.8	97.3	97.7	98.2	98.6	99.0	99.4	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	6.9	7.3	7.1	6.9	6.8	6.7	6.5	6.4	5.8	6.5	7.1	6.6	6.2
Office Vacancy Rate (%)<1>	16.3	16.8	16.8	16.9	17.0	16.8	16.7	16.6	14.7	16.5	16.7	16.8	16.5
Industrial Vacancy Rate (%) <1>	5.3	5.7	5.8	5.7	5.7	5.6	5.6	5.5	4.7	5.0	5.6	5.6	5.4
FINANCIAL MARKETS													
Money Supply (M1)(% change)	7.9	16.8	18.8	12.1	10.1	7.3	7.1	6.4	7.0	9.1	12.9	10.7	6.3
Velocity of M1 (% change)	-1.6	-12.2	-11.7	-6.1	-5.3	-3.2	-2.4	-1.5	3.3	-2.6	-6.7	-5.8	-0.5
Value of the U.S. Dollar (Trade-Weighted)	119.5	114.2	108.0	106.6	105.2	104.4	103.6	102.8	138.3	143.2	111.9	104.0	100.9
Percent Change	-24.5	-16.5	-20.1	-7.2	-3.0	-3.0	-3.0	-3.0	10.4	3.5	-21.9	-7.1	-3.0
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	715	719	670	680	663	663	688	694	675	688	696	677	744
Personal Saving	146	153	109	107	124	119	116	115	169	143	129	118	147
Savings Rate	5.0	5.1	3.6	3.5	4.0	3.8	3.7	3.6	6.3	5.1	4.3	3.8	4.4
Gross Business Savings	569	566	561	573	539	544	571	579	506	544	567	558	597
Federal Deficit	-202	-238	-209	-227	-185	-187	-213	-227	-170	-198	-219	-203	-240
State & Local	70	59	58	61	60	59	58	58	69	62	62	59	62
Net Foreign Investment	129	143	142	156	161	163	162	159	91	115	142	161	154
Uses (total gross investment)	708	687	678	681	700	694	691	681	662	661	689	691	721
Nonresidential Investment	458	457	458	457	457	454	453	451	422	461	457	454	457
Structures	148	133	131	130	131	131	132	132	141	152	136	131	134
Equipment	310	324	327	327	326	324	322	319	281	309	322	323	323
Residential Investment	186	193	192	190	187	182	180	179	171	177	190	182	181
Inventory Investment	40	15	1	3	20	16	11	-1	59	9	15	12	13
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	10.4	9.9	9.8	9.5	9.3	9.1	9.0	8.9	13.8	12.2	9.9	9.1	8.7
Real Mortgage Rate<3>	4.4	4.4	4.6	4.7	4.9	4.9	5.1	5.3	6.4	5.5	4.5	5.0	5.4
1-year ARM (without buydown)	9.6	9.2	7.8	7.3	7.0	6.8	6.7	6.6	12.5	10.1	8.5	6.8	5.4
Real Mortgage Rate	7.1	7.4	4.9	4.7	4.2	3.8	3.7	3.5	8.6	6.8	5.8	4.0	2.2
Corporate AAA Bond Rate	9.6	9.0	8.8	8.6	8.3	8.1	8.0	7.8	12.7	11.4	9.0	8.0	7.3
Government Bond Rate	8.9	7.7	7.4	7.2	6.9	6.7	6.6	6.4	12.5	11.0	7.8	6.6	6.0
Real Government Bond Rate	2.9	2.2	2.2	2.4	2.5	2.5	2.7	2.8	5.1	4.3	2.4	2.6	2.7
Federal Funds Rate	7.8	6.9	6.2	5.7	5.5	5.3	5.2	5.1	10.2	8.1	6.7	5.3	5.4
3-month T-Bill Rate	7.0	6.1	5.6	5.1	4.8	4.6	4.5	4.4	9.5	7.5	6.0	4.6	4.7
Real 3-month T-Bill Rate	4.5	4.3	2.7	2.5	2.0	1.6	1.5	1.3	5.6	4.2	3.3	1.8	1.5
1-Year T-Bill Rate	7.9	7.5	6.1	5.6	5.3	5.1	5.0	4.9	10.9	8.4	6.8	5.1	5.2
Real 1-Year T-Bill Rate	5.4	5.7	3.2	3.0	2.5	2.1	2.0	1.8	7.0	5.1	4.1	2.3	2.0
Prime Rate	9.4	8.6	7.9	7.3	7.2	6.7	6.8	6.8	12.0	9.9	8.3	6.9	6.7
Discount Rate	7.4	6.6	5.8	5.2	5.1	4.8	4.7	4.7	8.8	7.7	6.3	4.8	4.7

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates = Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns